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WHO'S WHO IN THIS ISSUE

BOWMAN SCOTT

A graduate of the City and Guild of London Institute in Science, Mr. Scott came to Boston, Massachusetts, after spending several years in business in England. His article, "What Causes Nationalization of Industry?" was written while he was studying for his Master of Business Administration degree at the Harvard Business School in 1948-9. Mr. Scott formed an "international team" of foreign students to help him gather material, but the other committee members felt that their contribution was so small compared to his that his name only appears as author. The results of his research excited much favourable comment and Mr. Scott was in great demand as a speaker on nationalization. He has since returned to England, and we have been asked to withhold his present position to avoid its incorrect association with this article.

JOHN CHARLES ROGERS

Mr. Rogers is President of Leverage Fund of Canada Ltd., a director of Commonwealth International Corporation Limited, and has been active in the mutual fund field for the past several years. As Provincial Chairman of the Payroll Savings Section of the National War Finance Committee for Quebec, he gained considerable experience in methods for reaching the small investor. Born in London, Ontario, and educated at McGill University, Mr. Rogers was subsequently with the Investment Department of The Royal Trust Company.

GORDON BOWES COYNE

A graduate of the University of Toronto in Political Science, Mr. Coyne is Toronto Branch Manager of The Standard Life Assurance Company of Edinburgh, Scotland. With the late R. Dunbar he co-originated the Estates Analysis Life Insurance service over 25 years ago. Mr. Coyne joined Standard Life after nine years in the field for Canada Life, and six years later was appointed Manager of the Toronto office. Born in St. Thomas, Ontario, Mr. Coyne received his A.B. from Toronto in 1911, and after studying at Osgoode Hall, was called to the Bar of Ontario in 1914.

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Dr. Fox is Professor of Business Administration at the University of Western Ontario's Business School and Director of its Division of Research. He received his M.S. degree from the University of London and his Ph.D. degree from the University of California. From 1937 to 1940 he was Teaching Assistant in Economics at the University of California,

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and in 1940-1941 attended The Brookings Institution, Washington, D.C. on a fellowship. During the war years he was successively Associate Industrial Economist, Office of Price Administration, Washington; Washington Representative, Canadian Wartime Prices and Trade Board, Washington; and Special Representative, Canadian Wartime Prices and Trade Board, London, England. Before coming to Western Dr. Fox was, in 1947, Canadian Textile Administrator.

CARL B. FLEMINGTON

Mr. Flemington is Secretary-Manager of the Credit Bureau of Greater Toronto and President of the Associated Credit Bureaus of Canada. Before joining the Bureau, he was with the Bank of Montreal at various points in Ontario, the Maritimes and Newfoundland. He holds the M.C.I. degree from the Canadian Credit Institute and is now immediate Past President of the Toronto Chapter. Mr. Flemington is also Secretary of the Credit Granters' Association of Toronto and is Canadian Editor of the *Credit World* the official organ of the National Retail Credit Association in the United States. He is the contributor of "Credit Forum", appearing currently in the *Maritime Merchant*, Halifax, N.S.

JOHN R. WHITE

Joining Imperial Oil Ltd. in Toronto in 1944, Mr. White became Vice President and director of the company the following year. He is also a director of the International Petroleum Company Ltd. Mr. White was born in London, Ontario and received most of his education there, though he took his degree in mechanical engineering from the University of Toronto in 1931. From 1931 to 1933 he was with London Rolling Mills Ltd., London; from 1933 to 1937 with Imperial Oil, Sarnia; and from 1938 to 1944 with the Standard Oil Company of Venezuela and its successor, Creole Petroleum Corporation. Mr. White is a member of the American Society of Mechanical Engineers and of the Association of Professional Engineers of Ontario (mechanical branch).

THE QUARTERLY REVIEW OF COMMERCE



What Causes Nationalization of Industry?

Bowman Scott

From a study of individual industries in Europe and North America Mr. Scott draws the causes which led to their nationalization, the advantages and disadvantages subsequently encountered, and the significance of these developments to the businessman.

WHAT BRINGS ABOUT the nationalization of an industry? Is it possible to generalize on the causes? To throw some light on these questions this article describes how nationalization got its start, particularly in the European countries. It goes on to discuss some of the advantages and disadvantages claimed for nationalization and the expedients developed to make it work; and it concludes with raising some questions as to what business men can do about it.

This article is not intended to persuade the reader that nationalization is right or wrong. Its purpose is to provide for business men a general background for consideration when making decisions, not only on specific proposals for increased government participation in business but also on business problems which may influence the growth of a tendency towards nationalization.

A Definition of Nationalization

It is desirable to begin by deciding what we mean by nationalization. There are varying degrees of government control in business. There is first a legal framework which includes, in Canada for instance, the Combines Investigation Act and the patent laws. The next stage is government regulation of business, which is perhaps closest in the case

of natural monopolies such as public utilities. Next come the businesses which depend largely on government loans, subsidies, or assets which have strings tied to them enabling the government to influence the management—this influence is particularly felt when the business isn't doing too well, as in the case of the aircraft manufacturers in the U.S.A. Finally comes the stage of government ownership to the extent that the government, whether the ownership is mixed or not, has working control of management.

For the purpose of this article the use of the word "nationalization" is restricted to the final stage, at which the government, through ownership, controls the direction and management of the business.

How Does Nationalization Start?

Nationalization is by no means new. In Canada, for example, there is the Canadian National Railways and in the U.S.A. there are the Federal Reserve System and the Tennessee Valley Authority. In 1938 American President Lines was virtually nationalized when the U.S. Maritime Commission acquired control of nearly 93% of the voting stock.

The factors that lead up to nationalization can be divided into three groups: economic causes, the attitudes of the people, and the effects of the international situation. Of these groups, the first two can be influenced and offer the best area for action to those who wish to affect the development of nationalization. The international situation can have far-reaching effects, but is less easily influenced.

Economic Causes of Nationalization

Insufficient risk capital. A lack of risk capital for basic industries essential to the country's economy has led to nationalization of a large number of industries. France nationalized the electricity and cement industries, whose rapid expansion was necessary for postwar reconstruction. In Sweden the government had to provide the capital from the start for the airlines and for most of the railways. In these cases the economy was also said to benefit from lower financing costs which resulted from the ability of the government to borrow at much lower interest rates than those available to private interests.

In some cases the risk and thus the difficulty of attracting private capital has been accentuated by the need of facing losses for several years before the investment would show any return. This has been the case in the westward expansion of the Canadian railways. Even the Canadian Pacific Railroad was government-owned from 1874 to 1881. In Britain the coal mines not only needed capital for modernization, but also faced losses while capacity was being geared up to a higher level.

It may well be asked why the government concerned did not provide the capital by means of loans and cover initial losses by subsidies. In most cases government reluctance to do so can be traced primarily to

the mistrust of private business by the government in power, and a feeling that money belonging to the public should not be used as a means for providing private profits. In Britain, France and Sweden this mistrust springs from a wide gap in understanding between management and labor. We may ask ourselves whether closing this gap would result in such decision being based to a greater extent upon the relative efficiency of the methods of administration, rather than upon a trial of strength between the interested groups.

Going back one step further, some of the factors that lead to a lack of risk capital may themselves be regarded as possible causes of nationalization. In some cases there is a shortage of money for private investment due to heavy taxes on those likely to invest. In others the risk factor is too large for the money to be attracted at a reasonable interest rate, particularly if the country is unsettled as France was immediately after World War II, and preservation of capital becomes the guiding factor for most investors. The shortage may also reflect a general lack of any desire to take a risk as arose in Canada in the 1932 depression.

These factors may be imagined rather than real; for example, under the threat of nationalization since 1919, the British coal industry was allowed to run down because the owners felt that they could not attract capital on reasonable terms. On the other hand, the British steel industry, under a similar threat since 1945, continued with a \$670,000,000 reconversion plan and has succeeded in attracting the capital required. We may wonder, therefore, if aggressive leadership by management in the last 10-15 years could have prevented many industries from falling into the state, as it were, of seeking "public assistance."

Need for central control. Another economic cause of nationalization is a need for a single authority to plan and control an industry throughout the country. This may arise from a need for coordination and for avoiding uneconomic duplication of assets, services or research. Common examples are the natural monopolies such as railways, airlines, and electric power.

The alternative to nationalization is to allow a monopoly and to control it. As is known only too well in North America it is not easy to control monopolies, and many governments prefer to hold the reins themselves. Furthermore, this is often said to be more efficient since it avoids the dual administration involved in the regulation of monopoly. The problem arises, therefore, as to whether legislation can be developed that will control natural monopolies economically while maintaining a healthy structure.

Economic recovery. An urgent need for national recovery may often initiate nationalization through development of the feeling that if a controlled economy was successful during wartime, then it will be successful in peacetime. When cooperation is found to be lacking because

people do not feel so patriotic, the reaction is to nationalize in order to enforce the plan. This happened in the case of road transportation in Britain which did not want to fall in with controls limiting competition with the railways.

Nationalization as a logical development. In some cases industries are already so closely linked with other government operations that nationalization seems a logical development. This happened in the case of the British Cable & Wireless Company which was closely associated with the Post Office telegraph services. This idea of nationalization as a logical development is often quoted when a government owns part of an industry. If the government-owned part is more efficient, then the rest may be taken over to improve it as has been the tendency with the T.V.A. If the government part is less efficient, there is the desire to take over the rest of the industry to spread the loss, as happened in the case of the Swedish railways, or possibly to prevent any standard being available for comparison. These results all tend to show how once the government becomes involved in business the temptation arises to protect its activities by legislation which results in a spreading mesh of controls.

Control of financial institutions. The need for financing large government debts, and the methods of monetary control developed for influencing the economy of a country, have led many governments to take over the central banks whose operations have then become similar to those of the Federal Reserve System or the Bank of Canada, though somewhat closer control of credit may be exerted. In France one reason for nationalization of the insurance companies was to enable the government to tighten control of capital investment since the banks and insurance companies were the sources of the majority of funds.

In Britain the proposal to nationalize the insurance companies was modified, under pressure from the Co-operative Insurance Companies, to a proposal to mutualize the companies in order to retain the support of the Co-operative Movement. Although the Labour Party states that the intention is to protect policy holders and not to obtain control of the funds of the existing companies, opponents of the scheme feel that the government will still be able to exert considerable influence on the use of funds by means of regulations controlling the operation of mutual insurance companies.

In Italy the need to prevent a banking panic had the secondary effect of nationalization of business. By 1933, as a result of the depression, the assets of most banks were frozen in industries with almost no earning power. In order to provide sufficient liquidity the government formed the Industrial Reconstruction Institute, which took over the industrial commitments of the three major banks and a majority of their stock. The original intention was to sell these for private ownership, but in 1936 the need for industrial mobilization for the Abyssinian War,

coupled possibly with the fact that many companies were becoming profitable under increased activity, led the government to hold on to them so that they continued as nationalized businesses.

Production capacity. Disagreement between government and business as to the level of production required is likely to lead to nationalization. If businessmen feel that extra capacity will not be justified in the long run, expansion capital will not be forthcoming and the government will, if it feels strongly enough, either start a new plant or nationalize and direct expansion. The Labour party in Britain states that it will not risk dislocation of its economic program by shortages or overproduction of basic materials and gives this as one reason for nationalizing coal, steel, electricity and coal gas.

Source of income. Last in the economic area is the prospect of using an industry as a source of government income, of which the main example is the manufacturing of tobacco in France.

Attitudes of the People as Causes of Nationalization

Desire for security. Perhaps the strongest influences on the attitudes of people are the fear of a depression and the memories of the hardship and mental strain of being out of work. These lead many workers to clamor for government ownership in the belief that they will thereby get a guaranteed job; this is particularly true in the highly cyclical coal and steel industries in Europe.

Poor management-labor relations. The failure of management in its responsibility to improve management-labor relations and efficiency leads to the development of restrictive practices by both management and labor. These are complementary. On the one hand, labor costs are increased by activities such as featherbedding, while on the other hand, management agreements are made by various means to fix prices at an economic level that allows the increased costs to be absorbed by manufacturers without losing trade to competitors. The result is a steady drop in productivity which the government has to overcome in times of severe economic strain, particularly if it becomes necessary to bring prices into line with those of other countries to increase exports. Perhaps it is the fact that the working classes are the first to feel the pinch of a falling standard of living that has often led them, rather than management, to show the way in breaking the vicious circle.

Poor management-labor relations have not only led to inefficiency and demands for government assistance to industries, but have also resulted in growing labor mistrust of management and owners, a feeling often accentuated by the relatively large salaries received by top management and the substantial dividends received by stockholders. In France there was a strong reaction by labor against working to provide profits for other people, and for a long time the strongest demand for steel

nationalization in Britain came from steelworkers themselves and was founded largely on distrust of management and owners.

Although unions have been recognized in Europe for years, the workers felt that in many ways their recognition did not result in their wishes being given satisfactory consideration, and the gap between labor and management was kept up through defensive attitudes on both sides. Frustration felt by some labor elements made them react to the extreme left, and led to many demands for the ownership of business to be taken into the hands of the community and for control to be put into the hands of the workers. This was the only solution they could see after years of getting nowhere. These demands appear in Socialist and Communist party manifestos which voice the discontent and distrust built up through years of neglect of labor relations and the physical conditions of depressed communities.

The danger here lies in the fact that the majority of people concerned sincerely believe that their ideas and catch phrases are right even though they may be demonstrably unsound economically. When such movements become popular and powerful, any counter publicity is suspect and ridiculed. This stimulates those interested in private enterprise to draw away still further from labor in countering the attack, and leads to a well-defined split between right and left. If either side predominates, the result may be reactionary legislation such as nationalization which accentuates the trouble. If neither side predominates, the result may be as in France, a middle of the road government whose policies, consisting of watered down elements of the extremes, may often be self conflicting.

Management-public relations. Failure of management in its responsibilities to the public may build up a feeling strongly hostile to free enterprise, and lead to demands for nationalization or at least close regulation, although the basic problem may really be lack of the competition that free enterprise provides. An illustration of the persistence of this feeling can be seen in the case of the French companies whose owners were dispossessed by the government as a punishment for collaboration with the Germans during the war; these were run as nationalized companies, although the industries as a whole had not been nationalized, and continue this way because public opinion still reacts strongly against private ownership, rather than against the original owners. Any proposal to return arouses all the memories of the bad points of private enterprise.

Effects of the International Situation

Economic problems. The international situation in which a country finds itself often introduces strong pressures which may lead to nationalization. The economic situation may, as in Europe, accentuate the need for increased production to balance trade, and as in Britain, the very

urgency of the situation may result in the maintenance of many wartime controls. The temptation then arises to economize and simplify administration by nationalizing an industry instead of controlling it. Alternatively, it may be the international situation which precipitates the demand for more capital to increase production; this, in turn, may lead the government to nationalize the industry concerned. For instance, in Sweden the lack of steel during the war made it necessary for the government to open an uneconomical steel plant in the north of Sweden since no private capital could be attracted.

National defense or prestige. National security often makes it necessary to retain industries which are uneconomical. For example, it is generally necessary to ensure that a good network of railways is maintained for the transport of heavy war material at the expense of the development of road transport which may be more economical for a large proportion of the peacetime traffic. In France it is felt necessary to retain coal-fired locomotives since on the one hand the country lacks large oil resources and on the other hand electric trains are easily disrupted in war. The need for retaining uneconomical industries leads to a need for subsidies and here again this sets the stage for nationalization as soon as any other reasons, such as a need for coordination or central planning, arise.

In some cases the need for security is closely coupled with the idea of maintaining national prestige. This is particularly true in the case of the airlines in Britain and France and in the case of shipping in France and in the U.S.A.

Secrecy. The need for maintaining secrecy is another reason for retaining government operation of an industry as, for instance, in the case of atomic energy.

Bargaining power. The need for strengthening the bargaining power of a nation may result, as in Britain, in the nationalization of some trading activities. This has occurred in the case of rubber, cotton, and also foreign meat and wheat purchasing. Some of the cotton trade has since been restored to private dealers since government trading did not prove sufficiently skilled or flexible.

A Summary of the Causes of Nationalization

Many of the causes of nationalization mentioned are closely inter-related and normally several will exert an influence at the same time. It should not therefore be assumed that in the examples which have been quoted nationalization is the result of one factor only. Generalizing very broadly the writer feels that most of the causes of moves towards nationalization can be traced to:

- (1) A history of poor management-labor relations
- (2) A fear of depression

- (3) Unsettled international relations
- (4) A weak and unsettled internal economy reflected particularly in a shortage of risk capital.
- (5) The previous existence of government controls or nationalized industries.
- (6) A lack of government-business-labor cooperation.

The Advantages and Disadvantages of Nationalization

It is necessary to remember in this discussion that the advantages of nationalization can be presented relatively explicitly; the disadvantages take longer to explain because they are less tangible, and may therefore appear to carry more weight.

In France and Sweden the popular attraction is that nationalization means that the profits from the efforts of the workers do not go into the pockets of the "greedy capitalists." They go, in theory, to lighten the tax burden. This may seem relatively unimportant, but the feeling is real and strong among large segments of the population. Of course, one of the main replies to this is a query as to what happens when the nationalized business loses money, as it often does.

In Britain, a common attitude is that under nationalization all government money is used to the benefit of the country, and none is diverted for the use of private interests. Opponents of nationalization agree that some money may be misdirected by private interests, but state that the amount lost in this manner is small compared with the losses suffered by the whole economy due to lack of the incentive provided by the profit motive.

The simplification of administration, particularly when coordination or control calls for a duplication of administrative work, often is claimed as an advantage, particularly in countries trying to operate a planned economy. This simplification may be true from the point of view of the man at the top, although as more levels are added, inertia becomes greater; but the picture from below is often very different. In a government-run organization, where less latitude is normally allowed to executives than in business, the system can become very inflexible. Directives issued from the top to coordinate action may fail to cover, and even deny action to deal with, the thousand and one local problems at the bottom. Under these circumstances executives become frustrated and often find that taking no action is better than making a mistake. They may even come to believe that most problems solve themselves if left alone, not realizing that frustration has just gone a stage lower; ultimately, this rot can spread down to the lowest level.

Another advantage that is often quoted is that workers will work better for the government which represents them than they will for private interests. Furthermore, government ownership is thought to

give workers a greater sense of security. Now the fact that both workers and executives feel that they are in nice steady jobs sooner or later leads to an easygoing outlook, and sometimes results in more absenteeism when the individual regards the government as having a bottomless purse and an infinite patience. These intangible psychological factors are very important and the difference in outlook, in the zest for getting a job done or taking responsibility, has far more influence on the efficiency of the organization than mere size and inertia to which inefficiency is often attributed.

The increase in effort expected from the change from private to national ownership also proves short-lived. The workers generally find much the same management running the business after nationalization, but discover that instead of being free to deal with their grievances as before, the management is restricted by the rules and regulations of the national authority. On the other hand, if the labor unions are closely associated with the parties in power, when they appeal through their union they are often told to shelve their grievances because they present awkward problems to the government. This has caused much frustration and discontent in the case of the miners in Britain. In fact, the Trades Union Council, under pressure from the Labour Party, found it necessary early in 1949 to introduce a system of fines for absenteeism. So far the local union representatives have refused to accept it. The Labour Party also tried to use the idea of Socialism as an incentive, but, as with freedom, once the ideal had been attained, the incentive weakened.

The supervision of a nationalized industry by the government assembly may tend to bring even an efficient industry to a level of mediocrity. Officials get a feeling that every move they make is watched critically and tend to leave well enough alone and retard changes rather than take the risk involved in introducing new developments. Long range planning may be distorted to fit into the life of the existing government, or to fall into line with temporary political manoeuvres. It may also be restricted by the fear that the government will meddle with it and produce an unsatisfactory plan anyway.

Although supporters say that nationalizing a business is preferable to allowing a monopoly, it really has many similar dangers. It places large powers in the hands of the government officials concerned and offers opportunities for patronage and totalitarianism. This may take the form of personal graft or preference in the allocation of contracts or supplies to private manufacturers who support the party in power by gifts or other means.

If there is no free competition, the public pays for any inefficiency through higher prices and also suffers from having to accept what is offered when there is no means of representing the fact that the needs of the public in terms of price and quality or service are different. In

Britain joint production committees include consumers in an attempt to overcome this problem, but in France the formation of councils of enterprise has not been very successful, owing to selection of members who were poorly qualified for the work.

If the nationalized industry is unsuccessful financially there is the risk of continued public subsidy or protection. For instance, if non-nationalized businesses are competing satisfactorily, there will be a temptation to increase controls over the competitor as in the parallel case of the Civil Aeronautics Board in the U.S.A. which is restricting non-scheduled airlines so as to keep to a minimum the cost of subsidies to regular lines. Alternatively, if the competition arises from outside the country, tariffs may be introduced, as was done to protect French prices.

Nationalization of the banks meets with comparatively little opposition since it puts necessary powers in the hands of the government to facilitate control of the economy. The real disagreement arises on the policies for using these powers rather than on their existence.

There is sometimes a tendency amongst a series of nationalized industries to pass the buck when things go wrong; for instance, the steel industry may blame failure to meet output on the coal industry, the coal industry on the lack of labor, and so on. This leads to complacency, and there is the trouble. Time and again, people are found sitting back and doing a mediocre job, happy because of the feeling of security. There is a serious risk of losing incentives that build up the vitality and drive that lead to efficient operation; but nobody becomes particularly worried!

Limiting the Disadvantages of Nationalization

Various expedients have been tried to limit the disadvantages of nationalization. Of these, the principle of the Public Corporation now widely used in Britain has shown promise, as measured by the ability to develop an improved standard of service while remaining financially sound, during more than 16 years' experience with the London Passenger Transport Board and the Central Electricity Board.

These public corporations are fully owned by the government but are financially autonomous, having powers in some cases to supplement the government capital with debt financing based on their own credit. The idea is to keep as close as possible to a business organization and thus avoid the limitations of a civil service atmosphere. The directors are appointed by the government minister concerned and are responsible for all operations except matters of major policy such as those affecting the general economic picture. There has been an effort to choose a path between formal ministerial control and a lack of any formal control: formal control might lead to the minister's trying to do the corporation's work and also finding himself attacked by political pressure groups; a lack of any formal control might lead to a complacent and unenterprising management, anti-government decisions, and an abuse of the power of

monopoly. The salaries offered to the directors and senior executives are high enough to attract very experienced businessmen, and are in many cases higher than the salary of the minister appointing them. Consumer committees function in an advisory capacity in order to provide direct recourse for consumers.

In France, in order to avoid appointment of unsuitable men the government chooses the directors for nationalized industries from a list of suitable people nominated by the industry. Also, in an attempt to reduce the unsettling effect of direct government supervision on the management of the coal industry, the coordination of the industry has been made the function of an office different from that responsible for the day to day operations.

What Should Businessmen Do About Nationalization?

Where nationalization has arrived we need to beware of the dangers of becoming accustomed to a gradual decrease in efficiency and being lulled into the pleasant thought that everything is going smoothly. It will be essential to evaluate the results year by year to ensure that we see the danger signal the moment the experiment has gone too far.

The obvious thing to do is to check up on financial soundness, but this may be made difficult by vagueness in reports and accounts, or changes in the accounting systems used. In France the fear has been voiced that these factors may hide the shortcomings of government control and lead to further demands for nationalization from people who think the results are better than they really are.

For other evaluation questions we can ask ourselves: how has the general attitude in the country changed? Is the atmosphere of nationalization itself causing a lack of enterprise and preparing the ground for more nationalization? Are controls spreading, either directly or indirectly through allocations of materials? Are controls being used to cover up failures? How efficient is nationalized business? As a side issue how can the efficiency be assessed? What criteria can be used? Are the consumers getting the right balance of quality, service and price?

It is also important to analyze the attitude of management. Has the atmosphere and spirit of the new organization compensated for the loss of other incentives? How long will this last?

How has the attitude of the worker changed? Is he sitting back with the feeling that his job is safe? How have the social customs changed? Has a sense of responsibility grown or is there an accepted atmosphere of absenteeism and padding of jobs?

How have management-worker relations progressed? Is the rift broadening or is there closer cooperation? Do the unions still serve their real purpose?

Most of these factors are difficult to measure and evaluation is made more difficult by the fact that we live in a dynamic economy. We must

be alive to the need for keeping our standards up to date and for maintaining an awareness of the limitations imposed by the current attitude of the general public.

In many cases the ordinary businessman would not have access to much of this information; so what can he do? Perhaps the most important thing is to ensure that a means of review of the efficiency of nationalized organizations by the government exists, and that the committees or boards making the review are well selected and receive the advice and services of leading businessmen as consultants.

Implications of Nationalization to the Businessman

Perhaps of first importance is the possibility of a return to private enterprise. This is a difficult step unless a change of heart in the elected government leads it to offer favorable terms for repurchase, since under government financing the industries benefit from the low interest rates paid on government securities. If nationalization has been accompanied by heavy taxes on income and accumulated wealth, private capital may be insufficient to finance any large scale repurchasing of government-held securities. It is also necessary to remember that the economy may have been so distorted by one government that it would take a successor many years to change back. In France, in an endeavour to promote increased individual responsibility, coal, electricity and gas are being allowed to become joint stock companies and to return to 49% of private ownership. The retention of government control in this case is said by some to give added confidence and to attract private capital; but will this always be so, or will it discourage private investors who want to exert control over this investment? In some cases return to private ownership may not be immediately practicable. The wartime Lulia Steel Plant in the north of Sweden is uneconomical but the government finds it difficult to close it because there is no other industry in this area to which the workers concerned could move. What can private business do here to facilitate the necessary changes and moves to other areas and industries?

The inability to control a monopoly has encouraged much nationalization. How can the businessman facilitate control and regulation without destroying reasonable freedom to compete? Workable controls may ward off complete nationalization.

Nationalized businesses enjoy many privileges which can have serious repercussions on the private businessman. For instance, what exactly is the meaning of a contract with a nationalized business? The businessman is unlikely to get penalty clauses included. Consequently, the only recourse is likely to be political which is slow and laborious. The businessman is also at a disadvantage in obtaining supplies since precedence will always tend to be given to the needs of other nationalized industries in deciding allocations. Similar preference will occur in exchange rates (as was the case with the multiple exchange rates in France) and also in

credit where the banks are nationalized. These factors react strongly against the small businessman, who may find yet another problem in selling the product he manufactures. The centralized control of nationalized industries leads to centralized purchasing. Consequently, the small producer may find himself losing business to the large private producers who are able to provide these large quantities.

Finally, how will the productivity of the workers in non-nationalized business be affected by their contact with workers in nationalized industry? Will a feeling of less security arise with consequent wage demands? It is also necessary to consider how union bargaining powers will be affected. Will they be made subject to the public interest as is likely in the case of nationalized industry? Will this lead to frustration and the growth of new unions?

Conclusion

Although there are many arguments for and against nationalization, the pressure for nationalization and the results accruing from it vary immensely with each individual case. It is further necessary to consider not only the immediate results but also the secondary effects, which may ultimately prove to be much more far-reaching. Most important of all we must look far ahead and try to decide what is the best policy for presenting a balance between individual freedom and the economic self-sufficiency necessary to allow people to enjoy their freedom.

Canada's Fastest-Growing Investment Medium

John C. Rogers

President

Leverage Fund of Canada, Ltd.

After outlining the basic features of the mutual fund, Mr. Rogers demonstrates why some one of the three types currently operating in Canada will appeal to every potential investor, and how such investment can influence the Canadian economy.

"Such (mutual fund) companies are media for the investment in the national economy of a substantial part of the national savings, and may have a vital effect upon the flow of such savings into the capital markets." Sec. (1) (a) (4), Investment Companies Act (1940), 76th U.S. Congress.

THE RAPID GROWTH of mutual funds in recent years has made this prophecy seem an understatement. Approximately one billion three hundred million North American dollars have been placed in these "media for investment" since 1940, and the current estimate of this flow, continuing at an accelerating rate, is one million dollars per day. The 16th Annual Report of a leading Canadian mutual fund shows that net assets were increased 74.46% in 1949.

This snowballing acceptance of mutual funds should not be shrugged off by the business executive as "something for the little fellow who doesn't know how to run his own affairs." Obviously, figures of this nature must indicate that many large investors have found this medium attractive as well.

What a Mutual Fund Is

Here in Canada, knowledge of the essential features of mutual funds by executives in all walks of industry and finance is very limited. There is instead a general feeling of, "We've been around that race-track before with the investment trusts of the late twenties". This is an unrealistic attitude, and it would be worthwhile for the executive to consider the mutual fund not only as a means for attracting the smaller investors' capital into the equity markets, but also as a new class of investment

medium competing with bonds, preferreds and commons for his own attention.

A mutual fund is in reality a constantly supervised investment account. Participation in a group of securities is continuously available to investors through the purchase of mutual fund shares ("units of beneficial interest"), at a price equal to the net worth per unit (plus commission) on the day of purchase. Any fluctuation in the market values of the securities held by the fund is reflected in the net worth per unit, and participants may withdraw their investment interest on any business day, without penalty or charge. Virtually all income received from the invested assets of the fund is distributed pro rata to the shares (or units of beneficial interest). The fund tries to do for the investor what he would do for himself if he had the time, experience and capital available.

The Four Factors in an Investment

All astute investors know that there are really only four basic features of any investment, around which all other qualifications revolve: liquidity, income, profit, and safety. They also know that these features are rarely found in balance, and are frequently in conflict. For example:

- | | |
|---|---|
| a bank account is | —tops in safety and liquidity but low in income and zero in profit potential. |
| government bonds are | —very highly rated for safety and liquidity but low in income and very minor in profit potential. |
| life insurance (for investment only) is | —unquestionably high in safety, slightly restricted in liquidity, low in income, and lacking in profit potential. |
| real estate mortgages are | —moderately high in safety, low in liquidity, quite good in terms of income, but again without profit potential. |
| high grade corporation bonds are | —high in safety, quite high in liquidity, quite low in income, and again very minor in profit potential. |
| preferred stocks are | —quite good for safety but weak on liquidity, and only moderate for income — very low, if any, profit potential. |
| individual high grade common stocks are | —let the reader set his own values. |

Possibly the foregoing review of well-known facts may appear pedantic, but it was after making such an analysis that the original designers of mutual funds attempted to create an investment medium which would combine all four basic features and still be attractive and available to all classes of investors.

The Importance of Liquidity

A well-known financier once said, "Investments are made to be

sold". What he wished to convey was that liquidity should be the first requisite of any form of investment. The value of ready marketability can be seen by the price usually placed upon it: *e.g.*, bank current accounts, no interest allowed; treasury bills, a return of less than half of one percent; savings accounts, one and one-half percent; government bonds, less than three percent.

All four mutual funds in Canada undertake to redeem their shares on any business day at full net asset value without penalty or charge. In other words, monies deposited in this form of "investment bank" are "demand deposits" available for withdrawal at their net worth at any time. It is this guarantee against being "frozen in" that is the basic difference between mutual funds and the investment trusts of the late twenties. It is by far the strongest point in favour of their use as an investment medium. Last year, American mutual funds re-purchased over \$67 millions from investors with no disturbance whatsoever.

Every day, at the close of the stock exchanges, the clerical workers of a fund —

- 1) compute the gross value of the fund's investments,
- 2) add to this figure the cash on hand plus other credits,
- 3) deduct any liabilities,
- 4) and thus arrive at the net worth of the whole fund.
- 5) By simply dividing this total net worth by the number of shares outstanding, they get the net asset value per share.
- 6) This is the price that the fund will pay other people for its own shares until a new valuation is computed the next day.

All the assets of a fund are composed of cash and negotiable securities and by virtue of this fact the guarantee to redeem shares is unquestionable in quality. Also, there is no actual danger from the remote possibility of a "run on the investment bank" by a large number of shareholders. "Runs" are caused by fears of inability to pay and ignorance of conditions. The fund's first line of defence is continuous full publicity on its operations. Secondly, all funds maintain some position in government bonds and other highly liquid securities of a stable market value. Thirdly, shareholders are spread over the entire country. Fourthly, similar to bank savings account, all funds have "panic hedge clauses" allowing for reasonable delay. At no time in the last twenty-five years has a mutual fund been embarrassed by its charter guarantee to redeem its shares in full at net asset value.

In a recent poll of over two hundred branch bank managers, when the point of liquidity was clarified, all agreed that mutual fund shares represent excellent collateral for borrowing purposes.

Referring back to our initial investment analysis, we have seen that mutual funds score high in liquidity.

The Income Opportunities of Mutual Funds

All investors are interested in income. Security values rise and fall partly because of the supply of money, but mainly because of the investing public's appraisal of the future ability of the security issuer to maintain or increase the income payable on the security. In Canada, where freedom still reigns in respect to a capital gains tax, many investors are primarily concerned with increasing capital rather than immediate income. However, behind this desire to increase capital is the object of building a sum for the future which will be great enough to produce the income desired. In this connection, the following chart will be of interest:

TO OBTAIN \$1,000 YEARLY YOU MUST INVEST IN

20 Toronto Stock Exchange Industrial Average Stocks	\$17,090
6 Gilt-Edged Preferreds (with sinking funds)	25,142
10 Corporation Bonds	30,549
Dominion of Canada Bonds (3%, 1966)	34,333
Savings Bank @ 1½%	66,666

All mutual funds make a practice of paying out more than 85% of their net investment income to the shareholders. One Canadian fund still makes a transfer from realized capital gains account to income account, but this is not the general practice. In the United States where there is a capital gains tax, the funds are also required to pay out a portion of their realized capital gains in the form of special dividends. This practice is due to necessity only, however, and the American funds are envious of the position of our Canadian funds in this respect.

A true mutual fund is built upon the solid principle of diversification, and is thus provided with many sources of income. "A river that is fed by many tributaries is less likely to go dry than a single stream." *There is no record of a mutual fund ever having interrupted its dividend payments.*

All of the foregoing has dealt principally with the reliability of income. As to the quantity of income, this is, of course, dependent on the investment policies of the individual fund. As mentioned above, all mutual funds pay out to shareholders something over 85% of net annual income. Mutual funds have a "good" rating for the income factor.

The Profit Potential of Mutual Funds

The investment of money for capital growth is too often regarded by the over-eager investor as a "sprint" whereas in reality it should be regarded as a "marathon". No short term spectacular results should be anticipated through the purchase of mutual funds. The very safety factor of diversification of assets militates against such an event. The purchaser of mutual fund units should regard his acquisition as a slice of an investment account. If he wishes to make a comparison with other results he should do so with the whole balance of his account. It is human nature

to rejoice in successful investments and to try to forget the bad ones. The management of a mutual fund is not allowed this "whistling past the graveyard" practice, but must look at over-all results daily, when the figures depicting the net worth per share are computed.

In order to evaluate the potentialities of the capital growth factor, it is obviously necessary to take into account the timing of purchases in relation to the ebb and flow of the security markets. In order to determine which is the time to buy or sell common stocks as a class, the investor must resist the very pessimism or optimism of the majority of his companion investors, and perhaps do the opposite; this is not always easy. There is, however, a simple plan which is frequently referred to as "dollar averaging". If an investor will adhere to a program of consistently buying a fixed amount of dollars' worth of a security, he will obviously get the most number of units when their price is lowest and the fewest number of units for the same dollar amount when the price is highest. Further study will show that his average cost will always be lower than the average price of the units.

If the industrial growth of this country is going to continue, then the unbiased judgment of the management of the fund in maintaining the stocks of promising companies in its portfolio, will, over a period of years, provide the investor with an eventual capital growth regardless of the current phase of the market in which he makes his initial investment.

One very important factor assisting the management of a mutual fund is the constantly recurring addition of new capital to the fund at varying phases of the security markets, providing the management with the "wherewithal" to take advantage of the different opportunities which present themselves. This factor also has a dilutionary effect on the percentage losses of past mistakes in relation to the gross asset value of the fund. ("Honest mistakes are made by mutual fund managers, just as medical men and lawyers occasionally come to the wrong conclusions.") For example, a \$40,000 mistake on a \$2,000,000 fund would represent a loss equivalent to 2% of the assets leaving 98% to be working to recover the loss. With the addition of new capital bringing the fund up to \$8,000,000, the 2% of assets shrinks to $\frac{1}{2}$ of 1%, leaving 99 $\frac{1}{2}$ % of the capital of the increased fund working to recover the $\frac{1}{2}$ of 1% loss.

The National Association of Investment Companies (U.S.) has compiled figures showing the composite management performance of its member companies for the years 1941 through 1948. The figures show a gain for these investment companies for these particular years of about 60%. This compares with a gain of approximately 40% for Moody's 200 Common Stock Index.

The profit potential of a mutual fund investment is quite good when

measured in comparison with other investment accounts or with fixed dollar value investments.

Safety in Investment

The two most important elements in achieving safety in an investment are, of course, diversification and continuous supervision. The theory of diversification is that ten securities are safer than one, a hundred safer than ten. No one could deny that there is less chance of loss—other things being equal—in owning shares of a fund based, for instance, on a cross-section of well-known bank or insurance or steel stocks than in simply owning one of such stocks directly. A fund based on a large number of bonds obviously gives more protection to an investor than just one or two even higher grade bonds.

If one basic principle of an investment company is diversification, another is continuous, experienced supervision. The layman has little conception of the extensive management machinery that is employed to supervise his investment in a well set up mutual fund. The statistics, the investigational field trips, the sifting of advice from hundreds of pertinent sources, are far beyond the capacities of individual investors.

All pensioners from pre-war days have discovered to their chagrin that safety of numbers of dollars is not the only factor to be taken into consideration in the assessment of the safety of an investment. They have learned that a dollar bill is measured only by what it can buy at a given time. They have seen its buying power shrink some 40% in the past ten years. On the other hand, during this same decade, holders of common stocks have not only received a return averaging better than 4½% a year, but also the upward trend of their dividend income has kept pace with the advance in living costs. Moreover, the market value of sound common stocks has increased during this period.

On this fourth factor, safety, the rating of mutual funds should again be considered "good".

Summarizing the Four Factors

Reviewing the above for the sake of including mutual funds in our earlier appraisal of other forms of investment, we have:

mutual funds are —good for safety, high in liquidity, good for income and quite good for profit potential.

Substantiating our analysis is the following quotation from a report on investment companies given at the recent convention of the Investment Bankers' Association of America:

"The shares of a well-managed investment company would seem to offer an investor a larger measure of protection of principal, reliability of income, marketability, and reasonable opportunity for appreciation, combined - - - than any other general class of security available".

Recent articles in such publications as *Fortune*, *Business Week*, *Saturday Night*, *Time*, and *Collier's*, have all excitedly hailed the advent of mutual funds as the answer to the problem of reaching the huge untapped pool of redistributed capital in the hands of the "little fellow". The value of funds in this connection cannot be over-emphasized. The business executive, however, should have a knowledge of the construction of funds and their merits to enable him to conscientiously endorse their use to the "little capitalist" and also to understand their use for larger accounts.

The Different Kinds of Mutual Funds

Previously in this article mutual funds have been referred to as a class of investment in the same way that bonds, preferred stocks and common stocks represent classes. This may seem a little far-fetched as there are only four such funds in this country currently operating. The classification is, however, fully justified across the border where there are approximately ninety different funds. Moreover, the Canadian picture is changing rapidly, and several new funds may be expected on the Canadian market in the coming year.

All funds possess the basic features of redemption of shares at full net asset value, continuous offering of new shares at a price based on net asset value plus commissions, diversification of assets, and continuous supervision.

Fortunately for the stock exchanges, there is never unanimity of opinion on either the quality of individual stocks or the best manner in which to invest one's money — fortunately, because there would then be no trade. It is only natural, therefore, that no two fund managements are likely to have exactly the same objectives in their investment policies.

On the Canadian scene, we now have the three basic types of funds designed to meet the investment desires of the conservative, the middle of the road, and the aggressive types of accounts. These types of funds are popularly known as "Balanced", "Diversified Stock" and "Leverage" funds respectively. In the United States, with the broader security markets, further sub-classifications are available in the form of Bonds funds, High Grade Preferreds, Low Priced Preferreds, Quality Commons, Low Priced Commons, etc., and in industry funds such as Steel shares, Chemical shares, and even Television shares.

Such sub-classifications are unlikely to develop in Canada where adequate diversification within an industry is not possible; so, fortunately for the length of this article, only the basic three will be discussed. For the purpose of anonymity the four Canadian funds will be referred to as A, B, C and D.

Fund A—is the oldest and is a "Balanced Fund".

Fund B—is the largest and is a "Diversified Stock Fund".

Fund C—is the second largest and is a "Diversified Stock Fund".

Fund D—is the newest and is a "Leverage Fund".

Balanced Funds

A balanced fund may be described as a fund whose management adheres to a policy of maintaining flexible proportions of bonds, preferreds and commons in its portfolio of investments. For example, one fund might have a latitude in bonds of never less than ten percent nor more than twenty-five percent; similarly in preferreds, never less than twenty percent nor more than forty percent — and ipso facto, never less than thirty-five percent nor more than seventy percent in commons.

The following is a quotation from the literature of Fund "A" — a balanced fund. "Fund A at all times has its funds invested in three classes of securities; i.e., bonds, preferred and common stocks. The percentage in each class is varied in accordance with the judgment of the management as to the relative merits of each class under prevailing circumstances. Such a program permits a measure of relative stability. This also provides valuable purchasing power which may be drawn upon to acquire additional common stocks in periods when declining prices may have made them increasingly attractive; conversely it permits switching into additional preferred shares, or bonds when the financial outlook is obscure".

From an American balanced fund: "Balancing safety against risk—low income against high income—and growth possibilities against stability of principal, is a task which, if skilfully accomplished, fulfills the purposes of a prudent investment. In reality a "balanced fund" is essentially the type of fund in which an investor could, with confidence, place his entire savings. For, instead of representing a kind of security, it represents a complete investment program".

The popularity of the conservative balanced funds is in direct relation to the investing public's attitude toward the stock market; hence in 1947 most net capital was raised by the balanced funds, but in 1948 and 1949 the common stock funds went into the lead in sales.

Diversified Common Stock Funds

A diversified common stock fund is the basic and simplest form of fund. Its investment policy is primarily concerned with the prudent distribution of its assets according to industry and the selection of the best common stocks within each industry. The price stability portion of its investment portfolio rarely attains magnitude although management powers permit full exercise of judgment in this connection. Its very simplicity and constancy of policy probably account for its popularity.

Fund B says in its prospectus: "The investment policy of the company seeks to permit a degree of management freedom sufficient to obtain balanced diversification and to take advantage of investment

opportunities both as to time of purchase or sale and the selection of securities therefor . . . the policy of the company is to select for the portfolio securities which, from time to time, appear to be attractive from an investment standpoint. A balance is sought between adequate income and appreciation possibilities".

From the literature of Fund C: "The past nine years have been an extremely interesting test period. . . . Certainly the future years will also witness changing conditions. To the solution of those future problems, Fund C will continue to bring the same sound investment principles it has employed in the past — careful initial selection of portfolio securities; wide diversification among many industries and companies; continuous supervision by an experienced staff of investment specialists . . . providing adjustments to changing conditions in the years ahead."

Leverage Funds

The word "leverage" when applied to investments has been used for many, many years by financial analysts but is still unfamiliar to the ears of the average investor. Fund D, which employs the term in its title, was launched at the beginning of this year and since that time its interpretation and misinterpretation by investors and security salesmen alike has been wide and varied.

Discussion of "leverage" should be divided into two parts—leverage on income, and leverage on capital values; otherwise confusion of objectives is bound to result. Income leverage is the primary purpose of Fund D and capital leverage is the interesting corollary.

Income leverage is, in fact, the basis of the banking system of this country and elsewhere throughout the world. It is simply the hiring of money at one rate of interest in order to rent it out at a higher rate. Outside of the commissions and charges for sundry services rendered, income leverage is the main source of the bank shareholders' dividends. A Canadian chartered bank accepts loans to itself in the form of customers' deposits on which it pays interest ranging from zero to one and one-half per cent. It then re-loans this money to others at a higher rate of interest and thus earns the difference in these two rates for its shareholders.

Fund D under its borrowing powers, restricted by its charter, rents money at a low rate of interest and invests it in a wide list of sound securities at a substantially higher average rate, and thus earns the difference for its shareholders.

Income leverage is also present in the capitalization of any industrial company which includes bonds, bank loans, or preferred stocks. A prominent public utility company, for example, is presently employing about fifty percent leverage. (Fund D is restricted by its charter to a maximum of 33 1/3% leverage and at time of writing is employing about

15%). This public utility is allowed to earn 8% on its assets so that by hiring money through the medium of bonds at about $3\frac{1}{4}\%$ it is able to earn the difference of $4\frac{3}{4}\%$ for its shareholders.

In contrast with the public utility company, the assets of which are stable in value although non-liquid, and whose bond leverage is on a long term basis, the management of Fund D has highly liquid assets, whose fluctuating value must constantly be appraised to determine the amount of leverage it is prudent to employ. Management has the facility of a freedom of decision due to the short term nature of its borrowings.

From the prospectus of Fund D: "Leverage is feasible when the capital of a large number of people is combined in the fund, as money can then be borrowed at favourable rates of interest to be utilized for investment by experienced management, which has available to it the technical aids essential to the long term investing of money".

The fluctuating nature of the fund's widely diversified assets causes an accentuated movement in the net worth of the shareholders' participation in direct relation to the degree of leverage applied. This presents interesting results in the form of capital leverage.

It is because of the possible effects of this capital leverage that many people bring up the obvious and odious comparison with margin buying. The management takes a mature view of this subject and does not consider that a sound principle in the management of money should be completely shunned simply because it has been abused so often by people whose desires for capital gains overcame their better judgment.

"The fund . . . with all the advantages and safeguards of a mutual fund, at the same time provides a facility (leverage) directly under management control that can accentuate the upward price movement of the common shares. This accentuated movement will, of course, operate on the down side unless the effect of leverage is then reduced or eliminated".

Example: effects of a 25% increase, and of a 25% decrease in the portfolio value of two funds, of \$1,000 shareholder capital each — #1 Fund without leverage and #2 Fund with 20% leverage.

		25% increase	25% decrease
#1 Fund	\$1,000	\$1,250	\$750
#2 Fund	\$1,000		
20% leverage	200		
	<hr/>		
	\$1,200	\$1,500	\$900
		Deduct lev. 200	200
		<hr/>	<hr/>
		\$1,300	\$700
		<hr/>	<hr/>

Management approach to the determination of the degree of leverage to be applied at any time is to appraise the stability or growth quality of its assets in the light of the current economic outlook, and then within the restrictions of its charter increase or decrease its borrowings to the best advantage of the shareholder.

From the prospectus of Fund D: "Leverage takes the place of selection of speculative securities. Money judiciously borrowed for investment in fundamentally sound securities, not the speculative nature of individual securities, is relied upon to give the greater-than-average velocity in price movement and the greater-than-average income which many investors seek".

In Summary

Shares of beneficial interest in a mutual fund represent a low priced unit investment possessing strength through the diversification of completely liquid assets; income in keeping with the current rate on equities; capital growth through ownership interest of a cross-section of national industry; ready marketability because of the self-liquidating clause in its charter; a constant supply of additional shares, and continuous supervision by full-time management whose performances and results are constantly subject to the healthy spotlight of publicity.

Who Should Buy Mutual Funds?

Here then is an investment medium worthy of the attention of every kind and class of investor. Low unit cost and constant availability are two factors which combined create a wide variety of methods of purchase enabling the investor to adopt a program suitable to his own purpose. Take for instance:

Insurance Companies: A characteristic of their investment problems is their own steady growth of assets in the form of new cash to invest. A "dollar averaging" program carried out over the years will ensure an investment whose average cost is always lower than the average price paid per share. All four funds are eligible under the rule whereby insurance companies may invest up to 3% of their total assets in securities which do not necessarily qualify under the Insurance Act. Funds A, C and D offer discount provisions for large subscriptions. Funds A, B and C are, in the opinion of counsel, legal investments for insurance companies registered under the Canadian and British Insurance Companies' Act (1932) as amended.

Trust Companies: The ever widening acceptance of the excellent services of trust companies by people of smaller means, while welcomed by the companies, presents particularly grave administrative and investment problems. With income and succession duty taxes so tremendous, the proportion of small trusts will continue to grow rapidly. The other

side of the tax squeeze in the shape of low interest rates is creating a need for the higher yields available only in equities. Just as with an individual account, it is almost impossible to adequately diversify a small trust without incurring all sorts of extra commissions and costs. Furthermore, the use of equities makes more acute the necessity for wide diversification, careful selection and constant supervision. For the small trust funds, where management and diversification are major problems, mutual fund shares may be a very logical solution.

Corporation Pension Funds: "Will Your Savings Pay for a Party?" was the title of an editorial of the *Montreal Gazette* (4/2/50). It reminded readers of the famous story of the German family at the time of World War I who made daily sacrifices for years for the sake of keeping up father's annuity. Unhappily the postwar inflation came along, so that: "It is true father got his annuity. It is also true that it was paid to him in full according to the contract. But by the time he collected it, the purchasing power of money had so changed that the long thrift of the years proved negligible in its results. Father celebrated the coming due of his annuity by holding a family party. The whole proceeds of his annuity just paid the bill. No doubt the decline of money values in Germany after the First World War was extreme and fantastic. But the fact is that money values are declining in North America and declining very seriously".

Hundreds of Canadian corporations, both large and small, are today proudly establishing pension funds for their employees. Some companies are assuming the investment management of their own funds while others are employing established institutions to carry out their programs. The investments of these pension funds should not be controlled solely by managers whose investment training has been of the "Dollar Liability" variety. Common stock equities furnish the only readily liquid income bearing investments which can be expected to keep pace in any reasonable degree with the purchasing value of the dollar. The features of mutual funds, recited above, demonstrate their values to the managers of pension funds who recognize the need for a portion of their funds to be in equities.

Eleemosynary Institutions: Religious organizations, schools and colleges, homes and hospitals, libraries, clubs, lodges, cemeteries, etc. — these organizations usually have a conscientious group of public spirited citizens on their boards of trustees who are torn in their desires to: (a) furnish their respective institutions with as much revenue as possible, and (b) avoid any criticism through incurring undue risks with the capital. The salient features of safety, continuous supply, income, liquidity, and constant supervision inherent in mutual funds explain the preference that so many trustees have for this investment medium.

Corporation Reserves: Many large Canadian corporations have built up substantial investment accounts in equities in recognition of the income tax provision that "there is no tax on the dividends received by one taxable Canadian corporation from another". Those who are successful employ capable (albeit expensive) staffs to carry out the same investment principles followed by the mutual funds. Possibly some other corporations would like to build up accounts of this nature, but hesitate because of the risks and expenses involved. Mutual funds may be the answer.

Wealthy Individuals: A commentary on the probate of the estate of the late Franklin D. Roosevelt says: "Despite broad diversification, however, the tax appraisal revealed a weakness which is fairly typical of a great many such lists of investments. Among the many individual issues, most of which represented sound well-situated companies, there were some 16 securities which had become worthless. *Because investors never buy worthless securities*, it follows that they became worthless while owned.

"This, of course, indicates a lack of adequate supervision which is often characteristic of the investment accounts of people who are busily engaged in other activities. Such supervision, however, is available at a very moderate cost; and when compared to the 'cost' in terms of losses on securities which become valueless, the amount is negligible". Even those individuals who maintain a staff of their own to follow their investments may find these mutual fund features attractive: (1) ability to acquire a cross-section of the stock market in one purchase (three funds in Canada allow discounts for large purchases); (2) ability to liquidate a cross-section of the stock market in one sale operation; (3) relief from accounting requirements in connection with dozens of dividend cheques, proxies, tax reports, etc.; (4) in the event of succession duties, liability for Federal and for the Province in which the estate is domiciled, only.

Professional Men: Doctors, dentists, clergymen, lawyers and all others whose activities prevent them from devoting the time necessary to properly manage an investment account constitute a type of investor likely to benefit directly by the use of mutual funds. "Investing by whimsy — which is to say that a man invests entirely upon his own hunches, superstitions, financial fallacies, what others tell him, insufficient or erroneous information — or upon a score of other failings, physical or mental — is not so uncommon as we often think.

"The success of the mutual investment fund is . . . based upon the ability to make cold, calculated, unemotional decisions — judgments based on carefully developed facts. It means the difference between an investment program which makes steady progress and one which has become lost in a forest of uncertainty." (Extracts from *The Prudent Investor*.)

Branch Bank Managers: A few years ago the Investment Dealers' Association of Canada conducted a public opinion poll on the question

of where people preferred to go for investment advice. Highest in favour was the local branch bank manager because of his reputation for integrity and experience in money matters. However, most Canadian banks expressly forbid their managers to select stock investments for their clients because of the obvious dangers in accepting this form of responsibility. Despite this situation, people do and will continue to seek advice from their bank manager. In respect to equity investments, mutual fund shares eliminate to a large extent the hazards of selection of individual stocks because of the diversification often referred to above. Any banker who takes time out to study the construction of mutual funds will recognize the fact that in approving the purchase of mutual funds by his clients he is in effect merely agreeing to the purchase of common stock equities as a class and not "going out on a limb" as regards the selection of individual issues.

Young Executives: A good rule of thumb as to what proportion of an individual's account should be defensive (bonds, etc.) and what proportion aggressive (equities) is to take his age as representing the percentage for the defensive portion; i.e., at age 39, his account might be 39% defensive and 61% aggressive. Every \$1,000 can be divided into \$400 of Canada Savings Bonds and \$600 of mutual funds, with the \$600 being a slice of a large, continuously supervised, widely diversified, investment in equities. As his capital increases through financial progress, additions may be made in their proper proportions.

Payroll Savings: "Oh! Surely not a revival of this headache to employers!" Maybe not — but twenty years ago few top life insurance salesmen thought that group insurance could ever be successfully sold. The question is entirely one of whether "the game is worth the candle". Some points in this connection are recited later. The mechanics are simple. (a) The virtue of acquiring an ownership interest in industrial Canada is extolled to the employees. (b) Employees are then invited to indicate what weekly or monthly deductions they wish to set aside in this growth type savings plan. (c) The employer makes a gross purchase of shares of a fund each payday representing the total amount of employee subscriptions. (d) The shares are held by the employer registered "in trust". (e) Periodically share certificates, registered in his name, may be delivered to the employee. (f) In the event that an employee leaves the company, he may be given the choice of his stock or its equivalent cash value. Wartime experience in Victory Loan campaigns has shown that no other means of securing subscriptions from a large portion of the Canadian public can ever compete with the Payroll Savings Plan. The fluctuation of share values, implied endorsement by company management of any particular fund, attitude of the unions and several other objections are all answerable, and the question really resolves itself into whether management is really convinced of the value of making em-

along the same line, have done their job a little too well for the future development of this country.

ployees into "little capitalists" with a direct self-interest in the capitalistic system.

The Economic Implications of Mutual Funds

"I fail to see how we (Canada) can avoid being the most prosperous country in the world as time goes on". T. H. Atkinson, General Manager, Royal Bank of Canada.

"Sharing-the-wealth of the country can far better be achieved by making it more practicable for an increased proportion of the population to acquire an interest in the business of the country; in other words, to become capitalists themselves. If the worker is also an owner, it will open his eyes to the fallacies put forward by the 'something-for-nothing' boys who would skim the economic cream for political use, under the guise of the Welfare State". Merrill Griswold, Chairman of the Board, Massachusetts Investors Trust.

Economic and social factors are closely identified. The events and psychological phases of the first half of that "20th Century that belongs to Canada" have led us up to an impasse in our economic development which may be finally broken by the advent of the public recognition of the merits of mutual funds.

In the first decade with wealth in the hands of the relatively few, great ventures were undertaken but foreign capital was largely relied on. In the war-torn 'teens, Canada broke away from her dependence on England and the United States for development capital when she was forced to carry out her own Victory Loan campaigns. Then came the great progress of the twenties — a period that rarely, if ever, gets anything but condemnation; yet look around and consider how many of Canada's great industries of today owe their imaginative conception and initial capital to the spirit of Canadians at that time. There was no dearth of "little capitalists" then. Unhappily, their exploitation and encouragement to regard common stocks as speculative trading means, rather than as partnership participation in the development of industry, led to the financial stampede of 1929 and the resultant chaos of the early thirties. Surely it was not the common stocks themselves that were to blame, but rather the manner in which they were traded that caused the fiasco.

The hangover period of the early thirties and the remorseful aftermath built up a "never again" attitude that frankly classified investment in common stocks with horse-racing, roulette and other forms of gambling.

During the Second World War, the whole accent of governmental and industrial counsel to the "little man" was on security. Nine Victory Loan campaigns, preaching security, plus several different social measures

First, no money; then introduction to investments; followed by irresponsible and bad leadership on the methods of investing in equities; next financial loss and a feeling of having sinned; and finally the worship of security, is the economic story of Canada up to the opening of the second half of "Our Century".

It is now time to preach security in terms of the Bible story of the three servants and the talents — the bad servant who spent his in riotous living — the cautious one who put his away in a safe but static place — and the one who invested his wisely and multiplied it many times. Which one was the "good and faithful servant"? Which one achieved real security?

The Social Contribution of the Mutual Fund

Faced with the greatest need for development capital in our history, we have re-distributed our wealth into unenterprising hands made sterile by the very width of its distribution.

Let us be realistic about this redistribution of wealth that has taken place. It is wishful thinking that any popularly elected government is ever going to do anything about eliminating the measures which were — and still are — responsible. Nor are they going to restore the old distribution. If the capital is widely distributed in small amounts, then it is up to the seekers of that capital to create economic methods for reaching it.

Such methods, to be successful, must recognize the lessons of the past five decades. The "little capitalists" have been bitten before; they are not entrepreneur minded, and many are of a new crop that will have to be educated. Convention speeches, articles, and advertising in the press or on the radio will not achieve the purpose without an army of trained representatives to follow them up. Such representatives in turn must be rewarded financially. Probably the greatest social contribution of the capitalistic system of a financial nature has been life insurance — but salesmen are still needed to sell it.

Mutual funds have all of the characteristics necessary to provide the "little capitalist" with a sound investment, to give the salesman a suitable vehicle to sell, and to provide a means of raising vast sums for investment in the equity markets. "The more capitalist-investors, the stronger the nation, and the less likely it will be to succumb to the 'isms' now causing most of the world's difficulties".

Conclusion

Referring back to the opinion poll of the Investment Dealers' Association of Canada, the second highest rating for investment counsel went to the employer — the business executive. It follows that he should be familiar with this "modern way of investing" in order to be able to give counsel to others; probably, too, he will find many features attractive to himself.

O. Glenn Saxon, Professor of Economics at Yale University, says this, in part:

"If it is admitted that the cardinal principles of prudent investment are careful selection, scientific diversification and constant expert supervision, then the open-ended mutual companies are not merely another sound investment medium for the average investor, large or small, but they are the only medium available to him which offers both maximum benefits from its investment and maximum protection from the many risks of modern society".

The Dangers of the Self-Administered Pension Plan

Gordon B. Coyne

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The Standard Life Assurance Company

Mr. Coyne sets up a typical pension plan and discusses how it can be best administered, emphasizing the effects of an increasing longevity on the solvency of the plan.

Pension plans literature is increasing rapidly because of the currently growing interest in the subject on the part of government and industry. This article proposes to deal with only one part of the field, and that is superannuation plans for small and medium sized groups of employees whose title to benefits derives from services to a particular employer. Our conclusion will be that the "insured plan" is the only safe plan for groups of small or medium size.

A successful pension plan fulfills a socially desirable result for the community in eliminating the dependency of old age. To the employee, it gives a sense of security and an opportunity to work free from financial worry. To the employer as a business man, it gives the assurance of having amortized the yearly depreciation in the economic value of his employees, and of having thereby improved public relations for his company; and as a human being (or philosopher), it gives him the feeling of having done his duty to fellow workers.

Two Ways to Set Up a Pension Plan

An "insured plan" is a plan carried through a life insurance company which guarantees the pensions promised to employees, subject to the payment of premiums.

In a "self-administered plan" the employer carries all the risks on the basis of estimates provided by advisers. The employer contributes to a fund the estimated sums required from year to year, and from this fund the pensions are paid as they become due. The plan is operated by trustees who may either administer the fund directly or utilize the services of a trust company. Whether at pension age the annuities are paid directly from the fund or are purchased from an insurance company makes little difference, as will appear later.

A Typical Pension Set Up

To simplify the discussion let us consider a very popular and effective type of pension plan and set up some figures for a hypothetical

example. The points of advantage and disadvantage to be raised will apply generally to all pension plans, but will be set out in detail for this one in particular. Such minor provisions as withdrawal benefits and early retirement pensions are only barely referred to later. The following represents the bare bones of the plan:

Let us assume that the plan is to be inaugurated as of the 1st of July, 1950, and that after receiving advice and quotations from several insurance companies and an "independent" adviser, the employer has decided that he will adopt a plan under which employees with two years' service will be eligible for membership. The pensions are to be equal to $1\frac{1}{2}\%$ of earnings for each year of service after July 1st, 1950, plus 1% of earnings during the year ending July 1st, 1950 for each year of service prior to that date (excluding two years as required for approval by the Minister of National Revenue). These pensions are to be payable for life but will in any event be paid to the pensioner or his estate for at least five years. The employees will contribute 5% of salaries during their future years of service; the employer will supply each year any balance required to pay in full for the future service pensions earned during such year, or to set up funds estimated to be sufficient to finance the required pensions when they become payable. The employer will spread his payments for past service pensions over a ten-year period, the amount available each year being used to buy the past service pensions for those then nearest to pension age. This is called a Fixed Benefit Single Premium Plan.

As an example of how this would work: an employee with earnings of \$2,000 a year, having a credit of ten years of past service (12 minus 2), would under the terms of the plan be promised a pension of 10% of \$2,000 or \$200 per annum for this past service, and each year of future service would entitle him to a further pension of $1\frac{1}{2}\%$ of his earnings during the year (\$30.00 on his current earnings). Assuming these earnings to be unchanged and the employee to be now 35, this would mean $30 \times \$30.00$ or \$900 a year at 65. His total pension would then be \$200 plus \$900, a total of \$1,100 per annum. Of course his income (and his pension with it) will probably increase, but we have assumed that it doesn't to simplify the calculations.

The employer will have 5,000 employees eligible on the commencement date, and their total annual pay is ten million dollars. He finds that the insurance company giving the rates and conditions he prefers has quoted costs as follows:

First Year's Cost of Future Service Pensions to <i>Employees</i>	\$500,000
First Year's Cost of Future Service Pensions to <i>Employer</i>	\$500,000
Year's Cost of Past Service Pensions	\$500,000

While the independent adviser perhaps submits the same figures for an uninsured plan (self-administered), he may suggest that lower costs

of operation and mortality gains are likely to reduce the employer's contributions in the future; or his estimates may be lower than the insurance company quotation.

At this stage, the employer has the choice between an insured plan and an uninsured plan. How shall he come to a correct decision? The following facts should help him.

The Uninsured Plan Is in Effect a Small Insurance Company

As a first fact to bear in mind, the employer must realize that installing a self-administered plan is equivalent to setting up a life insurance company to serve his own limited number of employees. If a very large number of employees is involved it is equivalent to setting up a fair-sized life insurance company. He will then have the cost and trouble of organizing and overseeing the undertaking. If the number of employees involved is large enough to spread the risks widely, this may be worth while, although there are further dangers as will be pointed out later. As a measure of the conclusions reached on this question by employers in the United States: less than 10% of the plans approved by the Bureau of Internal Revenue prior to September, 1946, were self-insured (658 out of 6,862), and approximately 90% of plans adopted since 1942 (excluding some 3,000 profit-sharing plans) are carried through the medium of insurance contracts. These plans provide pensions additional to those provided under Social Security.

Pension Plans for Small Groups

The insured plan is so well suited to small groups of employees that practically no one challenges its supremacy in this field. What then are the definitions of a small group and of a medium sized group? Recognized authorities express their definitions below.

O'Neill's "Modern Pension Plans" comments: "Consequently for a personnel in the lower range of the intermediate size of from 100 to 2,000 (employees) an insured plan should be indicated. In the upper range, even where the eligibility rules would leave perhaps 1,000 eligible employees, this number likewise seems too small to provide a wide enough basis for self-administration. . . . However, a personnel numbering 5,000 or more employees is perhaps sufficiently large . . . to warrant a consideration of self-administration from a risk aspect. At this point, the number of eligible employees may provide a base broad enough to justify the assumption that the experience of the fund will be more or less in accordance with the expectations."

A report by the National Industrial Conference Board included the following: ". . . when the number of employees is less than 10,000, serious consideration should be given to the advisability of placing the risk with an insurance company."

A. J. Ostheimer of Ostheimer & Co., Philadelphia, remarks: "On the basis of our experience in this field to date, we do not feel there is any particular danger in the adoption of an uninsured pension plan by an employer with a very large number of employees, provided that the actuarial assumptions used in the plan are conservative and all inclusive, which should mean that the potential savings in outlay to the employer from the use of an uninsured plan would be small at best."

In several cases in the author's experience, where the eligible employee groups were from 2,000 to 6,000, the employers decided, after thorough and expensive investigations and after receiving reports from experienced proprietary actuaries, that at the premium rates available, they could not justify the risks of uninsured fund plans. The taking over of previously uninsured fund plans from trustees is not unusual for insurance companies. These include large plans which employers have found too involved and expensive to operate.

A hypothetical question on this subject may illuminate the point under discussion: Do you think that any financially responsible group would be willing to form a life insurance company for the sole purpose of administering one pension plan, even if it involved a group of many more than ten thousand lives, on any current rates of life insurance companies? Or even that an operating life insurance company would undertake the same task on the same terms if this were to be its sole pension plan? The answer is obvious. The insurance company would want a much larger group and these in variegated employments. Why then should an inexperienced employer take on the job? Answer — he seldom does!

What Does an Uninsured Plan Mean to Employer and Employees?

For any small or medium-sized group, an uninsured plan means: (a) that the employees will not be sure of what they will receive, or (b) that the employer will not know what it will cost; and often it may mean both, if the employer finds himself unable to make the payments required, and if it is found that contributions already made are not adequate for the benefits promised to date and already earned. For reason (a), employees almost universally prefer the insured plan. There are no *IFS* in the insured plan; and as the employees pay for pension plans, that is, for future service benefits, why not satisfy them?

In the past, some employers have been inclined to think that their contributions to employees' pension plans were charitable donations. No doubt this was the case in many instances. But today, particularly since the decisions in the United States that pension plans are a legitimate subject for union bargaining, it is realized that the employer's contributions under present social conditions constitute deferred pay.

What reliance may the employer place on the insurance company? And what on the adviser's estimate? The financially responsible insur-

ance company has made a firm offer. The employer can turn this into an enforceable contract. The adviser has made estimates. If they turn out to be lower than the actual later cost the employer must make up the deficit. The adviser has guaranteed nothing.

Further, there is no such person as an independent adviser for a pension plan.

What Is An "Independent" Pension Plan Adviser?

Some persons advertise that they are independent pension plan advisers; but the most vociferous are the least independent. One can find honest advisers who are not independent. They are: (a) proprietary actuaries who, if they recommend an insurance company, have no interest in commissions or fees from such company or who, if they recommend an uninsured plan, admit their personal interests in it on account of the continued fees to be expected; (b) life insurance actuaries and underwriters, experienced in the pension field, who admit their insurance connections.

On the other hand, one should not trust any adviser who pretends to be independent if in fact he is not so.

The proprietary actuaries will admit their interests. If any life insurance representative pretends to be independent, consider the following: he is, under Ontario law at any rate, licensed through some life insurance company. Does any such representative ever recommend an uninsured plan even in the case of a very large plan? He may not seriously argue the point, but his whole training has been in favor of insured risks. The author admits his own possible bias in this respect, and all the arguments in this article should be weighed accordingly. The facts and likelihoods must back up these points, not the author's opinions alone.

Naturally the life insurance representative prefers his own company; in fact, he cannot place business elsewhere except with its consent. The agent who, under these conditions, claims to be independent, is trifling with the meaning of words. And, of course, the "independent" life insurance agent who charges a fee but agrees to dispense with it if he receives the commissions is trifling with much more than words. Any life insurance company which sells pension plans will give free advice. Then why pay for it?

And how about "independent" advisers who are neither actuaries nor life insurance agents? Insurance companies naturally welcome all salesmen who plough the pension field; their objection is to those who pretend to be independent when in fact they are not. Their activities are not in the best interests of the legitimate advisers or of their clients.

Some of these "independent" advisers promulgate almost unbelievable statements. The words of one of them may be paraphrased as

follows: "The adviser must have no final interest in the plan finally agreed upon. We tolerate no deviation from this practice. Commissions are allowed by life insurance companies and if we finally advise that the plan should be administered by an insurance company, to avoid loss to our clients, we can arrange for commissions resulting from such a case to reduce or entirely eliminate our pre-arranged fee. Under no circumstances will we accept commissions on a basis which could possibly influence the consultant's recommendations and services."

There is no way under any provincial law in Canada for a life insurance agent to be legally able to apply commissions on account of a fee. In Ontario, if this adviser has a life insurance agent's license, it would seem that he contravenes the provisions of Section 294 (2) of the Insurance Act (Ontario).¹ If this adviser has no agent's license, then Section 281, (18) is a matter of interest: "Every person who assumes to act as an agent without the license required by this section, or while his license as such is suspended, shall be guilty of an offense." Furthermore, no life insurance company would allow this adviser a fee, even if it were legal, if one of its own representatives had previously acquired an interest in the case.

Summing Up the Two Kinds of Plans

In a nutshell, under the self-administered plan the employer doesn't know his costs; he operates on another's estimate, and there is no financial responsibility on the adviser. The employee is never completely protected for his earned pension.

Under the insured plan, the employer knows his costs each year. They are cleared each year and the resulting simplicity in bookkeeping in itself is worth dollars in the bank. The employee knows what his earned pension amounts to at the end of each year.

The preceding pages have been general in their comparisons. Let us get down to a detailed comparison of the insured plan and the self-administered plan.

¹ "No insurer, and no officer, employee or agent thereof, and no broker, shall, directly or indirectly, make or attempt to make any agreement as to the premium to be paid for a policy other than as set forth in the policy, or pay, allow or give or offer or agree to pay, allow or give, any rebate of the whole or part of the premium stipulated by the policy, or any other consideration or thing of value intended to be in respect of life, person or property in the Province, and every insurer or other person who violates the provisions of this section, shall be guilty of an offense." If the suggested use of the commissions is not a rebate, what is it? There is a further suggestion in the paraphrased paragraph that the adviser is able to obtain commissions from any of a number of insurance companies. Section 281 (13) states in part: "No life insurance agent . . . shall represent himself to the public by advertisement or otherwise as the agent of more than one such insurer . . .". See also Section 295.

Administration of Investments

The investment of funds is a difficult problem for any company without a full-time expert investment department. For such a company, it is generally recommended that the funds be placed in the hands of a trust company. Capital return and rate of future interest earnings may be guaranteed. The best current guarantee would not be more than 3% (most trust companies allow less) and that only for a plan of some size; the longest term the author has heard of for such a guarantee is ten years.

If not guaranteed, the greater part of the fund can reasonably be expected to earn a gross rate on invested funds of from $3\frac{1}{4}\%$ to $3\frac{3}{4}\%$ at the present time, but the trust company's investment and collection fees must come out of this; also an adjustment must be made for the fund's not being fully invested owing to the necessity of keeping cash on hand to cover current withdrawals, death and pension payments. It is possible also that on any major investments the client will be consulted and his time expended in making a decision on a matter outside his ordinary experience.

Fairly wide differences between gross and net earnings are quite common and it is doubtful that the net yield after all expenses on the basis mentioned above would be appreciably greater than $2\frac{3}{4}\%$ under present conditions. How long will these conditions continue? Bear in mind that promises to present employees will involve payments well beyond 50 years from today.

Insurance companies are in a particularly favourable position to secure satisfactory yields consistent with safety owing to their expert investment departments and their freedom to buy long-term investments at favourable times. Their uninvested funds at any time are a negligible percentage of assets. In addition, the mortgage investments of insurance companies (and these are an unlikely investment for the trustees of a small fund) offer excellent yields, and their loans to policyholders give a fair yield free from risk. Insurance companies discourage policy loans, but usually from 10% upwards of their assets are in this form. Accordingly life insurance companies' funds derive excellent yields and the security as compared to that of a small fund on an unguaranteed basis is of course substantially greater. An examination of recent annual statements of the life insurance companies, showing net yields averaging $3\frac{1}{2}\%$ to 4%, is evidence on this subject. And the increases from year to year in net yields as shown in their last three annual statements is likely to continue for some years. The life insurance companies put almost all their new funds into government bonds during the war. This reduced their net interest returns to the lowest point in history. Now they are able to obtain larger yields in other fields on new funds, but the average yield is still held down by the continued very large holdings of government bonds.

Expenses of Operation

The trustees of a self-administered plan must pay the legal and printing costs of trust agreement, booklets, and routine forms; must pay the costs of an investment department or trust company fees; absorb any net capital and interest losses; lose interest on unemployed funds; pay adviser's fees for preliminary estimates and all later calculations; pay actuary's fees for periodic valuation of funds and liabilities; pay costs of maintaining complete pension records; take the responsibility and pay the administrative costs of disbursing pensions, withholding income taxes, etc.; and must sometimes call on senior executives of the employer to decide matters of policy and interpretations.

All these things that the trustees must do entail costs to be provided from the fund, while the insurance company does all these things as service; that is, the costs are included in the premium payments and in a small charge for some withdrawing employees.² After installation an insured plan can easily be operated by a company clerk.

Guarantee of Capital, Interest Return and Costs

Trustees of a self-administered plan do not, of course, guarantee the capital, interest return, and costs of the pensions or costs of administration. Thus an exceptional longevity of only a few pensioners or even of one pensioner, if the pension is large, may upset the equilibrium of a small plan and either put the employer to unexpected costs, or, if these extra costs be beyond the employer's capacity or desire to pay, necessitate a scaling down of the whole plan. (In one case, the employer is thinking of scaling down pensions already vested.)

Insurance companies vary in their guarantees of premium rates for pension plans. The three main kinds of guarantees state that the rate schedule quoted in calculating the first year's cost of the plan:

(a) will be continued for the first five years of the plan. Thereafter the insurance company may establish new premium rates for all members of the plan both new and old. This is equivalent to a straight five-year contract, with a new contract to be negotiated at the end of that period.

(b) will be continued up to pension age for all employees joining the plan on the commencement date for salaries paid them on that date. For increments in pensions due to increases in salary and for all pensions for members of the plan joining after the first year, a new premium schedule or schedules may be used.

² Two years ago the expenses of the companies writing nearly all the group annuity business in the U.S. were reported to have averaged less than 3% of the premium income for the 10 years then ended. One authority also reported at that time that his investigations showed that the self-administered plan costs were usually at least 8%.

(c) will be continued up to pension age for all members joining the plan during the first three years of its operation, including increments in pensions due to all increases in salaries, subject to memberships being compulsory for all employees as they become eligible. This means that no increase in rates can be applied until the fourth year of operation of the plan, and any such increase in rates could only be applied to members joining in the fourth and subsequent years.

As an example of the advantages of these guarantees: at the present time, if the trustees of the self-administered plan decide to buy annuities for pensioners as they arrive at pension age, a pension of \$100.00 a month, guaranteed for 5 years for a male aged 65, would cost \$14,240.00 from one insurance company; but the amount the same insurance company would accumulate for the same pension if it operated the employees' pension plan would be only \$13,786.00. The trustees could obtain no guaranteed rates from this same insurance company, except perhaps at very much higher figures, for any pensions to be bought in the future.

Any possible advantage of a self-administered plan must therefore be discounted by some 3% to 10% (based on current tables) if it intends to buy its annuities as it goes along. And if it doesn't so intend, how can it spread its annuity longevity risk? For, if the trustees of a small or medium sized plan pay pensions direct from the fund the number of pensioners is likely to be very small in the first few years. Even if the group concerned should be as many as one or two hundred pensioners the longevity of these might average several years more than the normal. The fund would then be required to pay perhaps 30% more than the amounts estimated in setting up the plan. Such a deviation from normal might entail such unprepared-for costs as to bankrupt the fund. By buying its pensions from an insurance company this danger would be overcome as the cost of each pension would be met as the right to pension accrued. Instead of the handful of pensioners to which such a plan would be limited for some years, the trustees would need a minimum of many hundreds of members in the first few years to properly average longevity.

Trends in Mortality

Some data on mortality will be of interest. The following figures based on data covering lives of citizens of the U.S.A. have been formulated by the largest insurance company in the world.

"The expectation of life at birth in 1900 was 49.24 years; in 1947, it was 66.8 years. The expectation of life at 65 in 1900 was 11.86 years; in 1947 it was 13.29 years. We are not only living longer after age 65, but many more of us are reaching age 65; viz:

	1900	1950	1975
		Estimated	Estimated
Total population in millions	76	149.9	185.01
Number of persons aged 65 and over in millions	3.1	11.3	19.09
Percentage age 65 and over	4.1	7.5	10.08"

It will be noted that from 1900 to 1947, the increase in longevity from age 65 was almost a year and a half or a little over 11%. It will also be noted that for any pension plan in force in 1900, or even inaugurated much later, radical revisions must have been necessary many years ago to avoid disaster. Such has been the case, and for the uninsured plan this meant that the employer had to catch up on all the previous years of inadequate contributions as well as to supply the extras for future years. There have been numerous examples of this situation, and adjustment costs to the employers who kept their plans solvent ran to many millions of dollars; many plans are still insolvent. The uninsured plans have almost all run into a series of bankruptcies. In many cases the employers have paid large extra sums (often more than once) to revive the solvencies of the funds. In many cases they are still bankrupt. The reduction in interest yields was part of the difficulty but increased longevity was a major factor. There would have been no catching up required under an insured plan. The only change would have been in the future contributions.

But the statistical information now available does not complete the picture. Since 1900 medical science, largely on the disease-prevention side, has increased the life span from less than 50 years to almost 67 years. It has reduced the mortality of childbirth, successfully combatted the diseases of infancy and more recently attacked and conquered many of the diseases of middle age. Any prophecy of fifty years ago foretelling the actual results to today would have been considered preposterous. Now medical science is attacking the diseases of old age. Furthermore, in the last two years it has discovered ACTH, Cortisone and other drugs which, in the opinions of several eminent Toronto physicians recently questioned by the author, are likely to revolutionize our ideas of longevity.

And yet one pension plan adviser in support of uninsured plans, recently stated in writing: "Insurance companies use a mortality basis designed to be 'conservative'. Any profit from an excess of deaths beyond those assumed goes to the insurance company. Under a self-administered plan, the mortality profit goes to the employer. In other words, the company's costs are determined by its own mortality experience." These statements are quite true but ignore the reverse possibility, and the loss which would result for the employer from an increase in longevity.

The Effects of a Possible Increase in Longevity

And what would be the effect of even a few years' increase in longevity? Approximately three years of increased longevity from 65 would mean more than a 15% increase in the cost of pensions. To the employer this means roughly a 30% increase in costs of the future service pensions in such a plan as has been mentioned earlier; for of course the employees' contributions would buy only 100/115 of the pensions formerly bought with the same amount of money, and the employer must thus shoulder the cost of the remaining 15/115 and pay the higher new rates on this as well as 15% more on his regular contributions.

Now what is the dollar result? Let us suppose that the new longevity is considered five years from now, all contributions to that date having been made on the estimate based on ten million dollars of annual payroll, and the now current mortality table. Where the employer's share of the cost for future service pensions is now \$500,000, it would become \$650,000, a difference of \$150,000. On the past service costs it would become \$575,000 per annum instead of \$500,000 for the balance of the ten-year period. After adding the amounts necessary to make up for the under-contributions of the 5 years, the statement of changed costs to the employer would look something like this:

	For Future Service	For Past Service	Total
Annual contributions which should have been made over the past five years based on the new longevity	\$650,000	\$575,000	\$1,225,000
Annual contributions actually made and based on the old longevity	500,000	500,000	1,000,000
Annual deficiency in contributions	\$150,000	\$ 75,000	\$ 225,000
Total deficiency in contributions for the five year period	\$750,000	\$375,000	\$1,125,000
Add interest lost because of deficiency in annual payments (interest taken at approx. 2½% to a round figure)	\$ 62,000	\$ 37,000	\$ 99,000
Thus the deficiency which would exist as the plan starts into its sixth year would be	\$812,000	\$412,000	\$1,224,000
And the sixth year contribution itself, would have to be increased by	\$150,000	\$ 75,000	\$ 225,000

But of course changes will have occurred in the personnel covered by the plan. Many members of the plan will have withdrawn from company employment, many will have had salary increases, some will have died and there will be many new entrants. Let us discount the costs of the under-contributions for the five years by 30%, which would be a generous allowance for most plans. Let us ignore the natural increase in membership. The arrears would then be \$1,224,000 less \$367,200 (30% of \$1,224,000) and this would leave \$856,800 of arrears for the uninsured plan employer.

What about an insured plan? Under the (a) guarantee there would be a likely jacking-up of premium rates for future service pensions of approximately 15% in the 6th year; but no arrears, and no increase in past service pension costs. Under the (b) guarantee there would likely have been an increase in rates for future service pensions one or more years before, because the insurance company would almost certainly have acted earlier than the uninsured plan operators. Self-administered or uninsured plans have been notoriously slow in the past in adjusting themselves to changed conditions. Although under the insured plan the employer would have paid somewhat more than he had anticipated, his total contributions during the five years could hardly be even \$200,000 more than the contributions originally contemplated and there would be no aftermath. Under the (c) guarantee there could have been no change in the rates until the fourth year and then only for new entrants, so that for decades to come the employer's yearly contributions for future service would not be likely to approach the uninsured plan figures; and he would have no arrears. Again a 15% increase in rates is assumed.

In cases (a), (b) and (c) there would be no increased costs for past service pensions. In any case a saving of \$75,000 a year for several years is indicated.

And of course the insurance companies use a mortality basis intended to be "conservative". They have been long in business and have over the years accumulated special reserves and surpluses to take care of the hazards of the business. But if self-administered, the newly hatched fund would be in a precarious position as shown.

Life insurance companies both mutual and stock are financially responsible to a degree unknown in any other class of business. No policyholder of any old line life insurance company has ever been known to lose a cent of money contracted to be paid to him through failure of any old line life insurance company in the history of Canada.

Flexibility

We quote again from an "independent" adviser: "*The nature of insurance and annuity contracts restricts the type of pension plan that is practicable under these arrangements.* On a trusted basis there may be a great variety of pension plans, and this means that features of great

advantage can be incorporated. The pension can, if desired, be made a percentage of final salary (the percentage depending on length of service); adequate provision can be made for those who must retire early because of ill health; and benefits on death or termination are not limited to the surrender values of policies."

The italicized words are not true. All of the features mentioned are available in insured plans, but the greatly increased costs (and the uncertainties as to the amounts of these costs) of these features to the employer usually result in the employer's not taking the extras. The same costs would apply to self-administered plans. It would almost appear from the wording of the quoted paragraph that on a trustee basis (self-administered plan) there is no cost for these extras. There is a very heavy cost whether the plan be insured or trustee.

The employer's costs would rise very substantially if all these suggested "features of great advantage" were incorporated in a plan to provide: "adequate" (probably meaning "much larger") pensions for regular pensioners on the basis of final earnings; in the event of retirement through illness the full pension which would have been earned by regular pension age; extra special benefits in the event of termination of employment or death (extra death benefits are already provided by most employers through group insurance). The more benefits the better, but not at the expense of breaking the employer. These benefits will come in time but just now the general thought is to expand the number of employees covered as pension plans become more widely applied; then will come greater benefits. First the horizontal expansion; then the vertical.

Summary

IF the various costs borne by the trustees, excluding investment costs, are not greater than the insurance company's loadings and employee-withdrawal charges,

IF the investment portfolio succeeds in procuring continuous net interest return of better than $2\frac{3}{4}\%$ after allowing for costs of investment operation and capital and interest losses,

IF the number of employees reaching pension age is not greater than the adviser's calculations have assumed,

IF the longevity of pensioners is not greater than provided for under the annuitant's mortality table used,

Then this particular uninsured plan will have been a success.

But for how long? Only while the balance of the *IF* factors continues to register in the plan's favour on the full term to date of balance. Let us suppose that at the end of five years such a plan shows an estimated savings in costs of half of the employer's contributions for the year — a very unlikely estimate to begin with, and only an estimate. Even so, this

is almost meaningless. The next few years may see a much greater loss than the previous gain and the employer is *never* sure. Future dangers will hang over his head like the sword of Damocles. The insured plan will let him sleep in peace. Even in the unlikely event that the uninsured plan should save costs through the years, will it have been worth the possible loss of peace of mind to the executives? Worries on the part of company executives may result in losses in the operations of the business of many times any possible gains in the costs of the pension plan.

A company considering the installation of a pension plan for its employees has several courses of action from which to choose.

First: Shall our pension plan be set up and its receipts, payments and investments be administered by trustees of our own? Or by a life insurance company? and if the latter, by what life insurance company?

Second: Shall we call in a competent life insurance company pension adviser? Or someone else?

Third: What will a satisfactory plan for the current and future services of our employees cost us: The first year? Thereafter?

And lastly: What can we afford to pay for "past service" pensions, pensions for older employees who will not have a sufficient period of future service to build up adequate pensions?

On the basis of the arguments presented above, the best advice appears to be: see a competent life insurance pension man; state your case; hear his preliminary advice. It will cost you nothing. This will give you some basis to go on and won't take too much of his time. Then compare rates and conditions of the life companies which are in the pension field. There is nothing but grief for you in giving full data about employees to several companies and obtaining quotations on some defined plan from each of them. Their submissions will bewilder you and will put all the companies but the one you ultimately select to a lot of unnecessary calculations. Compare the basic rates and conditions. Each company can put them on one sheet of paper. If in doubt after checking these, call in a proprietary actuary to advise you which company gives the best terms. His fee for this will not be excessive. Then call in one of the selected company's experienced pension plan men and let him advise you as to the details of the plan. When these are settled, put the plan in force at the earliest practicable moment.

The New Trade Rules: A Challenge to Canadian Businessmen

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Businessmen have an immediate responsibility to appraise the desirability of the Havana Charter, and Dr. Fox outlines Charter provisions, major criticisms, and the basic considerations which will influence the businessman's attitude towards this important departure from existing trade policies.

There is no need to plead the importance to Canada of a flourishing international economy. Any means towards the expansion of export and import trade is of vital concern to every Canadian.

A means of major dimensions is at hand. On March 24, 1948, the representatives of more than fifty nations, responsible for 90% of the world's international trade, met in Havana under the sponsorship of the United Nations and agreed upon a new set of rules to govern world commerce: the Havana Charter. They agreed, too, upon a body to interpret and administer those rules, to be closely affiliated with the United Nations as its trade arm: the International Trade Organization.

The Conflict of Business Opinion on the Charter

The Charter and I.T.O. have been both hailed and denounced. Said Mr. Will Clayton, then Assistant Secretary of State of the United States: "This may well prove to be the greatest step in history towards order and justice in economic relations among the members of the world community." Mr. Clayton in his private life is a major figure in American business. Said Mr. Philip Cortney, President of Coty Inc., in describing the Charter to the Export Managers Club of New York a few months ago: "It is a bad and intellectually dishonest document."

What manner of beast is this that businessmen of stature, both devoted to the development of international trade, can find it in turn friendly and vicious?

Business Responsibility to Evaluate the Charter

Be it friend or be it fraud, the Charter will in all probability be up for ratification in Ottawa immediately following its ratification in the United States. Canadian businessmen have a responsibility to study and assess this plan, and to make known their judgment regarding its

impact upon them and upon their communities. Now is the time to formulate our basic policy on adoption of the Charter.

There has been little discussion of this thoroughly vital and complex document in the press or by our business organizations. It will intimately affect the lives of every Canadian—be he a manufacturer concerned with export markets, with imports of materials, or with competition from foreign suppliers; be he a merchant, concerned with sources of supply and the prices at which he can economically buy and sell; or be he a plainer variety of citizen concerned essentially with the general well-being of the nation.

This paper is directed to some highlights of the Charter, to common criticisms, and to what seems to be the balance of evidence at this date. Its purpose is to outline the basic considerations which will influence a businessman's decision either to support or to reject this Charter.

Introducing the Charter Provisions

In over one hundred pages of complex and often obscure terminology the Charter lays down the new rules for international trading. These range from broad statements of high purpose and little practical significance — such as a pledge of international cooperation designed to make trade freer — to detailed accounts of how goods are to be valued for customs purposes and to such specific provisions as the abolition of all restrictions on foreign motion pictures, excepting the allocation of some showing time for domestic productions.

The Charter includes nothing on specific tariff rates or quotas. These are to be handled by separate agreements, although it is no accident that the negotiations for tariff concessions have been handled coincidentally with the Charter provisions, and by the same people. The Geneva (and subsequent) Agreements have resulted in over forty-five thousand tariff concessions since 1947, motivated by the same spirit as motivated the Charter provisions. Both stem from the new realization of the importance of freer markets and a determination to implement that realization by constructive action. It is doubtful whether either type of agreement can exist without the other. Failure of the nations of the world to agree upon the rules of the Charter will inevitably damage the Geneva Agreements on specific tariff schedules.

The concrete proposals set out in the Charter are astonishing to anyone who has followed the world's history on international restrictions. Few of those aware of the bitterness of the early debates, held behind closed doors, believed that it would ever be possible to weld the international disagreements into a meaningful agreement. But it has been done. The Charter is in a sense a monument to five years of patient preparation and tedious negotiation and compromise.

The Charter is in a particular sense a Canadian achievement since time after time it was a Canadian delegate who reconciled important

divergent interests and proposed the eventually accepted compromises. It was not without cause that a Canadian chaired the Havana Conference, nor was it by accident that the Canadian delegation was such a potent and respected group in the international conferences. Canada has attained a stature far beyond her years and resources — the future of that stature will in important part depend upon our ratification of the Charter.

Specific Charter Provisions

Specifically, what does the Charter propose? The new rules cover four major areas: (1) tariffs (visible and invisible); (2) quota restrictions; (3) subsidies (export and domestic); (4) cartels and monopolies.

Visible and Invisible Tariffs

All members are pledged to negotiate with each other in good faith for further and substantial tariff reductions.

No new preferences, such as the Empire agreements, may be created. World policy will be towards the abolition of special treatment. Each member of the International Trade Organization must grant every other member the same treatment in all *future* dealings. If the United States makes a new agreement with Mexico on the importation of binder twine, that agreement also applies to Canada.

Of particular interest to Canada is the specific understanding that Empire preferences may not be increased (unless, of course, such increases are extended to all other I.T.O. members). The general tone of the Charter is such that these preferences should be reduced. Existing preferences will, however, be allowed to stand pending negotiations towards reductions.

The tariffs specified in the official tariff rates are of course only one form of trade restriction. *Invisible tariffs* have been a far greater concern to Canadian manufacturers and these must go. Improperly burdensome border regulations, prohibitive transportation regulations, unfair and discriminatory inspection systems which are not applied to domestic goods, are all prohibited. No longer will goods be held so long at the border, on one flimsy pretext or another, that they finally rot or become obsolete. If foreign trading is to be discouraged it must be done openly and through permitted means. Customs fees and charges are to be reduced to levels approximating the value of the service; the arbitrary gouging which has typified some customs arrangements must go. No nation is to be permitted to compensate for lower tariffs by raising its valuations. Independent national tribunals are to be established to hear the cases of complainants.

Quota Restrictions

Most economists would agree that even more restrictive than tariffs and arbitrary administrative regulations are the import quota systems which have become standard equipment in most nations since the war. Tariffs and bureaucracies can hinder trade but need not stop it; quotas,

however, set up limits which can not be exceeded regardless of competitive quality or price. When a nation rules that a million bushels of wheat may be imported in 1950, the gate is closed when the million are in. This may suit the purpose of the country imposing the quota, but its effects on world trade may be disastrous: prices may be forced to bankruptcy levels in an attempt to get some part of the allotted quota, long-standing trade connections may be broken, trade-marks and goodwill values dissipated.

In general, such quotas are prohibited by the Charter. There are important exceptions to this rule which have led to much criticism and these will be discussed further on. The prohibition is of obvious importance to Canada and demands close analysis.

Export and Domestic Subsidies

One of the most disruptive influences in international trading has been the use of subsidies. Faced with the prospects of falling employment or a shortage of foreign currency, a nation may very well decide that its manufacturers should sell at any price their products will fetch in the foreign market, and that the government itself should accept the responsibility of making up the difference between the price obtained in the foreign markets and whatever figure the exporting manufacturers may find satisfactory. The effects on the country in which such goods have been dumped have been harsh and violent.

Similarly, some nations have subsidized *domestic* sales at levels which have made it impossible for imported products to compete. Such subsidies of domestic trade have had much the same effect on international competition as tariffs would have had. These restrictions destroy trade and commonly lead to retaliation, with the net effect on both countries being undesirable.

Domestic subsidies present particularly difficult problems. The United States, for instance, chooses to support its farmers by keeping certain agricultural prices at artificially high levels. It cannot sell at these high prices in a competitive world market. Therefore, if the United States is to sell in the world market, without changing its basic system of farm supports, it must subsidize its farmers to the extent of the difference between world and domestic prices (or some other arbitrary figure which farmers find acceptable).

The Charter has had to take into account the potent hold which such policies have within certain countries, but nevertheless has been able to accomplish something positive. Member nations, in general, agree not to subsidize exports after the Charter has been in effect for two years. Meanwhile, the International Trade Organization must be immediately notified of any subsidy on exports, or domestic subsidies which will decrease imports: the amount involved, the groups whom it will affect, and the extent to which they are affected. Members must be prepared

to discuss the removal of such subsidies with any seriously prejudiced parties who protest to the I.T.O.

It is unfortunate that this section is so worded that it will in all probability permit the unlimited subsidization of primary products, particularly agricultural, for either domestic or foreign sale. This concession is one of the prices which must be paid for having the Charter — without it, the United States, for example, could not conceivably ratify.

Cartels and Monopolies

Finally, a word as to the Charter's position on cartels and monopolies. It was Canada that demanded the tightest restrictions on the operations of these predatory groups. The United States and some of the undeveloped countries concurred, but the United Kingdom and the continental countries, where the traditional faith in the value of vigorous competition is somewhat less than ours, were sympathetic to milder restrictions.

Canadian arguments seem to have carried. For the first time, the principle of competition is recognized as the ruling ethic of international trade. Each member is committed to destroy monopolies in restraint of international trade; and the I.T.O. is given power to investigate complaints of monopolistic practice, and to publicize its findings.

Summarizing the Charter Provisions

These then are the major and pioneering provisions of the Charter: the principle of non-discrimination among the member nations; the vigorous reduction of invisible tariffs, and the elimination of such invisible tariffs as improper inspection and extortionate fees; the reduction of export subsidies; and the control of cartels and monopolies.

What the Charter Does Not Provide

At this point it may be well to underline what the Charter is *not*. First, it should be re-emphasized that the Charter does not in itself embody specific tariff schedules. Procedures and principles are set up, but details are handled by country-to-country negotiation. Secondly, it is in no way a "world government": there is no impingement upon the sovereign rights of the individual members and no economic planning agency is involved; there is no power whatever to dictate what is to be produced — or burned — or ploughed under. Finally, it is not a policing agency with power to enforce adherence to the terms of the Charter.

The power of the Charter and of the I.T.O. is in their establishing of the rules of trade, their provision of a forum where complaints can be heard, and of a skilled body to investigate those complaints. The Charter provides a place where the guilty can be brought to account before the powerful and compelling pressure of publicity and world opinion. Where the offender persists in his violation, those who are injured will be released from their trade obligations to the offender, and will be free to retaliate in such a manner as the I.T.O. may deem appropriate.

Some Objections to the Havana Charter

The Inadequacy of Penalty Provisions

There are those who feel the absence of compulsion is a very serious detriment to the enforcement of the Charter's provisions. It is more realistic and helpful to realize that the Charter represents probably all that can be expected until such time as nations are prepared to cede their sovereignty in economic affairs to some international body.

It would be naive to suggest that the Charter is drawn in such a way that there will be immediate and vigorous repression of all those who break its terms; it would be equally naive to suggest that because there is no police power, the Charter is without significance. The simple fact is that there will be substantial pressure from member countries on those who violate its terms. The signatory nations have signed because they presumably believe that the Charter offers them real advantages; and where violation may lead to expulsion, no nation will violate casually. The penalties of exclusion are in themselves potent.

Communist Opposition to the Charter

What then are the other objections? First of all there have been great and anguished cries from nations of the Moscow group. The Charter has been roundly denounced as imposing "the mandates of Wall Street" on the helpless of the world — as being "nothing other than another instrument in the hands of the U.S. to enslave the rest of the world". It is significant that Russia is not a signatory and its opposition suggests that the Charter has strength beyond that conceded by other and more acceptable critics.

The Suitability of Charter Objectives

Another group of critics sees the Charter as too idealistic; they believe that the world is not yet ready for international cooperation, that nations are still too immature to act with this degree of harmony.

The merit of this view can perhaps best be assessed, as pointed out by Mr. Clair Wilcox of the United States Department of State, by contrast with that of a third group which insists that the ideals of international cooperation have been compromised; that the plane of agreement is too low; that the world is sighing for the cake of loftily conceived responsibility, and that Havana has thrown only the wretched crust of mediocre vision.

Both arguments cannot be valid; the Charter cannot be at once too idealistic and too down-to-earth. A balanced view seems to be that the Charter is a compromise; that without such compromise there could have been no agreement. It sets up ideals and objectives for which the nations of the world may work, but it does not stop at mouthing platitudes. The representatives could have stopped with a solemn declaration that they were opposed to evil, but they did not. They preferred instead to write a document by which men of good heart might live — if they so willed.

This meant a realization that no nation is prepared to destroy overnight the political and economic patterns on which it has been constructed—even where it believes that eventually such patterns must be radically reshaped.

Special Privileges for Under-Developed Countries

A more important basic criticism of the content of the Charter concerns the provision that permits economically under-developed countries which desire to industrialize to apply various protective devices which are denied to other members, such as quotas and increased tariffs. In general, industries which have been established in such countries between 1939 and 1948, and industries which process primary commodities, are eligible to apply for such exemptions. This is a potential source of much conflict, but without it the agreement to the balance of the Charter by these countries, particularly the Latin American nations, would have been impossible. Had these countries refused to join, they would have been free to use these devices at will. On balance, therefore, the world seems better for this concession to special interests. At least, there are formal procedures which must be followed before such restrictions may be instituted; some measure of control is given, and adherence to the balance of the Charter is a net gain.

Special Privileges to Countries in Foreign Exchange Difficulties

Other major criticisms centre about the right to impose quotas and to discriminate among suppliers, where the country is in exchange difficulties. This, of course, is a problem currently close to Canadian hearts. Briefly, the Charter provides that where the International Monetary Fund agrees that a country is in exchange difficulties, the country may have recourse to such protective techniques.

Critics argue that the availability of such permission destroys the purposes of the Charter: members, they say, should be compelled so to conduct themselves that they do not get into exchange difficulties. Many distinguished commentators point out that such difficulties can arise because domestic prices are too high (perhaps because of monopoly, or trade union policy, or too free use of the printing presses). Lower prices and increase exports—that will give additional, say, U.S. dollars. If it does not, leave foreign trade alone: as the domestic consumer imports, U.S. dollars become increasingly short, their value rises in relation to domestic currency, and as it rises, the desire to import falls. Purchases in the dollar-deficient country at the same time become correspondingly more attractive to U.S. citizens, and ultimately exports and imports reach classical balance.

Whatever merit there may be to this view, no nation, least of all Canada, is prepared to say that it will forego import quotas in time of need. Further, there is no general agreement as to which methods are best for so controlling the domestic economy as to avoid exchange emer-

gencies. Thus, the dilemma. If all quotas were prohibited, few countries could join. If quotas were permitted only where the I.T.O. considered that all other remedies for foreign exchange difficulties had been exhausted, member nations would in fact have surrendered to an international agency virtually complete control of domestic policy, without knowing in advance what that surrender entailed. In the present state of national thinking, agreement to such a policy of international control would have been unthinkable. The potential loophole for the admission of quotas was again the price of obtaining *any* charter.

It should again be emphasized that the Charter will control the use of quotas; without the Charter there will be no control.

Other Obstacles to Charter Success

Other difficulties are patent to any observer. It is well recognized for instance that government has not yet learned to control the operations of domestic monopolies. It will be many years before governments will have learned to control their international operations. The Charter has, however, made one significant step: there is international agreement that their activities are undesirable.

It is also recognized that if the European economies fail to recover, and most particularly if the United Kingdom does not once again become a heavy buyer in the dollar areas, the trend towards national self-sufficiency may well prove inevitable. The Charter's success in overcoming nationalist trade policies presumes a continuation of European progress towards approximately "normal" economies.

Conclusions

This then is the substance of the Havana Charter. This article has outlined its major provisions, discussed some of the primary objections, and expressed the belief that its adoption will be one step towards a better world.

To reject the first really major project aimed towards a civilized international economy on the grounds that the framework is delicate or imperfect, or to deny that a better economic world is feasible because of past tariff policies and the past effectiveness of self-seeking lobbies, represents a curious type of sophomoric cynicism.

Ratification of the Charter is mandatory if we are to do all that lies within our grasp to make the twentieth century Canada's.

NOTE: For further information the reader is directed to the following: for a comprehensive, critical but generally sympathetic treatment, (and one to which this article owes much in terms of its general outline, and certain of its arguments), see Mr. Wilcox's *A Charter For World Trade*, MacMillan's, 1949; also an article by Dean Acheson, "Economic Policy and the I.T.O. Charter", *Vital Speeches*, June 1, 1949. In the same issue of *Vital Speeches*, for an antagonistic article see "Havana I.T.O. Charter" by Philip Cortney. *The Canadian Banker*, Spring, 1948 has a critical article by Michael N. Heilperin. *The American Economic Review*, June, 1949, also has a critical article by Sir Hubert Henderson, "The Havana Charter".

Recent Trends in Retail Credit

Carl B. Flemington

President

Associated Credit Bureaus of Canada

Mr. Flemington points up recent developments in retail credit, assesses their impact on the Canadian economy, and explains the role of credit bureaus in the control of credit risks.

THE "economic extravaganza" enjoyed by retailers during the war years and those immediately following, is now terminated and people are seeking quality and value in merchandise. Individuals are becoming more and more credit conscious and retailers are highly cognizant of the part retail credit must play in the future, if sales volume is to be maintained.

Those engaged in the extension of retail or consumer credit are facing problems today which were practically non-existent during the war years. Government control of consumer credit then necessitated large down payments with comparatively short terms of contract. The tendency was to create a substantial customer equity, thus either ensuring satisfactory performance in completing the contract, or providing for repossession by the seller with little or no loss. The restrictions on charge account credit also resulted in a minimum of bad debt losses and collection expense.

The Transition to Normal Credit Competition

Since the withdrawal of regulations, competition in down payments and terms is fast assuming its prewar status. The intensity of this will increase as competition becomes keener and the supply of goods again exceeds the demand.

Wages of a very high percentage of the people in the lower income brackets, who form the bulk of those purchasing through instalments, have not increased in proportion to the rise in the cost of living. Accordingly their need is for smaller down payments, longer terms and a greater use of this type of credit. During the past few years, this has resulted in a substantial increase in the volume of both instalment sales and personal loans.

Current Trends in Retail Credit

It is interesting to note that retail credit sales, both charge and instalment, today represent approximately forty-five percent of total retail

sales. Some firms dealing with instalment credit only report ratios as high as sixty percent credit sales to total volume, and there would appear to be no indication that credit buying has reached its peak.

There is no limit to the type of merchandise which can be procured on an instalment basis and budget account customers may now enjoy limited charge account privileges through what is known as "revolving credit". By this method the credit department authorizes a definite account limit, determined by the amount of monthly payment which the customer agrees to make, and credit is then usually extended over a six-month period. For example, if the monthly payment agreed upon is \$15.00, the account limit would be \$90.00. The customer is then permitted to purchase merchandise up to this limit, charging the amount of such purchases to his instalment account. So long as the total amount outstanding does not exceed the limit previously set, the customer is entitled to make new credit purchases. This device bridges the gap between charge and deferred payment accounts.

Consumer credit is by no means limited to items of a durable nature, but includes all types of "soft goods", although credit terms offered on this type of merchandise are usually such that a larger down payment is required and the repayment period is much shorter.

The growth in the ratio of credit sales to total sales does not necessarily mean that a more liberal policy has been adopted relative to down payment and terms, but can be accounted for by ever increasing acceptance of credit practices by the stores in general and through added credit facilities offered to their customers.

The Rapid Growth of Consumer Credit

While no definite figures are available on the expansion of consumer credit in Canada, it is believed that it has been along the same lines as in the United States, on a per capita basis. In that country postwar credit expansion has been very rapid. In June, 1944, the total outstanding was estimated at \$5,168 million. In the same month of 1945, it had increased to \$5,697 million, in 1946 to \$7,762 million, in 1947 to \$10,992 million, in 1948 to \$14,132 million and in November, 1949, to \$17,823. The last figure represented approximately \$120 for every man, woman or child in the country. About 60% of the total consisted of instalment credit.

The Effect of This Growth on the Canadian Economy

It will be readily agreed that retail credit is to remain a potent factor in our economy. It provides for a lower cost to the consumer through the ability to buy the products of mass production on a time basis. It raises the standard of living of the masses by placing within reach of those in the lower income brackets "The Good Things of Life on Credit".

The expansion of consumer credit for both goods or money thus has many desirable features, but if carried to an extreme, may have a detrimental effect on our entire economy. Credit expansion has a tendency to heighten booms and to delay recovery from depressions.

While consumer credit is in process of expansion, business has gained an impetus to the extent of total obligations incurred; yet this in no way enables people to buy more for cash. In fact it reflects adversely when the additional charges for the accommodation are taken into consideration. Credit expansion also involves a reduction of future purchasing power, as in the majority of cases, those who buy on the instalment plan must curtail their current purchases to the extent of the reductions being made in their obligations. A purchase amounting to \$300.00 made today and requiring repayment at the rate of \$25.00 per month, means that in the vast majority of cases purchasing power will be curtailed by this amount during the twelve month term of the contract.

On the other hand, if the purchase has been wisely made, it reacts to the customer's advantage. A system of enforced savings has been imposed and some tangible return has been evidenced for his money, which in all probability would otherwise have been diverted to less useful purposes.

New instalment buyers are of course continually entering the market and as past debts are retired, future commitments are being made. A saturation point must eventually be reached but it is rather difficult to determine its nature or extent. The main factor in bringing about this saturation point will be a lack of confidence on the part of both consumer and granter as to security and future earning capacity. This tends to curtail buying, and to create surpluses which in turn necessitate reduction in staffs and wages. This condition would, of course, have been brought about sooner or later in any case but the height of the boom has been increased to a greater extent than otherwise.

After the peak has been passed and a contraction takes place, the retirement of an accumulation of debts at a lower wage level advances the time when the upswing might be expected. The upswing will not occur again until surplus stocks are cleared. Then the replacement of inventories is necessary; the demand for goods increases; employment conditions improve; and confidence is restored. The necessity to retire obligations, especially at a lower wage level, reduces the purchasing power of those with commitments and lengthens the period before demand will again exceed supply.

The Responsibility of the Credit Granter

It is clear that consumer credit will play an increasingly important part in our way of life. Its extension, as the word implies, is based on confidence in mankind. We must not, however, confine this to faith

alone, but ways and means whereby efficient operation is applied must be fostered.

Consumer credit is making a real contribution toward maintaining a high standard of living in Canada, but it would be fallacy to claim that it is void of all factors which are undesirable. If it is to make its maximum contribution, it must benefit all concerned. This type of credit has a very vital part to play in our economy, and if both grantor and grantee endeavour to keep commitments within reasonable bounds of capacity, the benefits derived thereby will far outweigh any detrimental factors.

The buyer, in order to promote sound credit, must not be oversold. In the vast majority of cases, over-selling is really over-buying, as the credit would not have been granted if full disclosure had been made by the applicant of his earning capacity and commitments. The seller has a responsibility to himself and also to the customer to refuse credit sales to those unable or unwilling to pay. This duty is not fulfilled unless he resorts to all reasonable sources of information on the customer's circumstances.

Sources of credit information in Canada have shown marked improvement in the last two decades.

The History of Credit Reporting Services

The first known credit reporting service was that founded by Sheldon Church, a New York business man, who had as his clients a number of local merchants. In 1841, Lewis Tappan organized the first country-wide service which later developed into the R. G. Dun & Co. In 1849, John M. Bradstreet, a Cincinnati merchant, inaugurated the agency which bore his name. Both organizations continued operations, serving their respective clients with distinction until, in 1933, their parallel roads met in amalgamation.

These agencies played a very important part in the development and expansion of credit in Canada, a tradition which is being efficiently upheld through the present operations of Dun & Bradstreet, Ltd.

In the development of retail credit in Canada, another firm of international repute has rendered excellent service, the Retail Credit Co., Atlanta, Georgia. Its Canadian interests are far reaching, and although pioneering in the field of insurance reporting, it is also contributing to the important work of sound credit granting along general lines.

It might be mentioned here that in the field of commercial credit, the Canadian Credit Men's Trust Association Ltd., with head office in Toronto and branches from coast to coast, has been serving wholesalers and manufacturers since 1910. They maintain a Clearing House for Trade Information, conduct regular discussion groups in various trade classifications and operate both estates and collection departments.

The soundness of the Canadian credit structure is in no small way due to the untiring efforts of credit reporting services.

The Development of Credit Bureaus

The rapid growth of what is now known as retail or consumer credit aroused a definite need for some type of "Cooperation for Credit Protection," which has resulted in the formation on this continent of what are known as credit bureaus, which are in the main merchant owned and controlled.

The need was first recognized in England in 1803, when the Mutual Communications Society of England was formed. This is reported to be the oldest credit organization in the world and is still in operation, having completed nearly a century and a half of continuous service. It was not until 1869 that a similar bureau was formed in Brooklyn, New York, followed by one in New York City in 1872 and one in Baltimore, Maryland in 1882. These formed the vanguard of approximately fifty other bureaus which were organized prior to the year 1900. From then on the idea grew rapidly, with the result that there are now over sixteen hundred credit bureaus in Canada and the United States operating successfully in the interests of those selling goods or services to the consumer.

In the earlier days, most of these agencies were privately owned and independent in operation, with no definite medium of cooperation amongst themselves. The need for concerted action was felt, however, and in 1906 a number of these offices became affiliated through the formation of the "National Association of Mercantile Agencies". In 1912 another group, known as the "Retail Credit Men's National Association," came into being. The year 1921 witnessed the amalgamation of these two fraternities into what is known as the "National Retail Credit Association", which is still the parent body of all consumer credit activities in the United States. The majority of Canadian bureaus are also numbered among its members, for purposes of inter-bureau reporting.

Credit Bureaus in Canada

The formation of the credit bureaus in Canada, chiefly in the larger centres, followed the pattern of those in the United States. In 1927, those in operation in Eastern Canada were unified in thought and action through the inception of the "Associated Credit Bureaus of Ontario and Quebec". With the idea of increasing its scope, its name was changed to the "Associated Credit Bureaus of Canada" in 1937, and incorporation was effected under a Dominion charter as a non-profit organization. The value of an association of this description is mainly the medium which it affords for rendering a country-wide service to its members, who require credit coverage on a national basis.

The operation of credit bureau offices at the present time appears to be divided fairly evenly between merchant ownership-control and private

enterprise. This presents a definite contrast to the situation existing a decade ago when the greater percentage of credit bureaus was sponsored by some form of merchant trade organization.

This development is no doubt due to the fact that during the war years government control of consumer credit was such that the use of credit bureaus was curtailed very greatly. As a result, in many of the smaller bureau centres, merchant contributions were sufficiently retarded that individual ownership was established.

It is, however, highly complimentary to the type of individual ownership existing that merchant cooperation and confidence is extended to such a degree. Cooperation is the keystone of credit interchange and its success depends upon the application of this factor.

During the five years subsequent to the formation of the Canadian Association, a number of bureaus in the Canadian West were admitted to membership, followed closely by several in the Maritime Provinces, so that the organization now includes 74 member bureaus from Halifax to Victoria—a chain of service from sea to sea.

Services Provided by the Credit Bureaus

The fundamental cooperative principle on which all bureaus are based is the pooling of ledger information by the various members, concerning the manner in which customers take care of their obligations. This can only be made available by the credit granters' listing the identity of their customers with the bureau. Upon receipt of an inquiry, all interested members may then be contacted by telephone or telautograph and the status of the account at date ascertained.

In addition to this, other data which might prove of value in considering an application for credit are included in the master file. Details as to employment, whether owner or tenant, notices of non-responsibility, police court items, together with newspaper clippings, etc., all form an integral part of the completed report.

The Trade Record or File Information, denoting the previous paying habits of an individual over a period of years, is generally provided verbally. Although this might be termed the essence of credit bureau reporting, it is only one of the many types of reports furnished by the bureaus.

The "Standard" written report, in addition to trade details, also covers such matters as employment, marital status, degree of residence stability, character, general reputation and estimate of financial worth. "Short Form" written reports provide similar details in abbreviated form. In addition to these, reports of a more specific nature include Personnel, Automobile Finance, Mortgage, Previous Residence, Commercial, and Insurance Reports.

Practically all member bureaus provide auxiliary services to general reporting, such as publication of a monthly service bulletin, collection of

past due accounts, location of missing persons, conducting of discussion groups for members in specific classifications, and forwarding of automatic signal service respecting derogatory items, cautionary notices, and the like.

Throughout the bureaus the utmost in uniformity of operation is maintained so that it is possible to provide service on a national basis to those bureau members selling from coast to coast.

The activities of the Associated Credit Bureaus of Canada are directed toward educating retail staffs in the procedure of sound credit granting. Much active support is extended to the Canadian Credit Institute which sponsors degree courses in credit work through the medium of university extension courses. This tends to raise the standards of consumer credit reporting in all phases of relationship between merchant and customer.

Education in the Principles of Sound Credit

Through what is known as the Credit Granters' Association of Canada, a programme is carried on which tends to create a keener interest on the part of credit department personnel in the performance of their duties, and to improve the standards of the credit granting profession.

The chief aims of the Credit Granters' Association of Canada are to:

- (a) create fraternal feeling among its members, and all persons engaged or interested in retail credit granting;
- (b) unite fraternally, for mutual benefit, protection and improvement of credit granting and credit granting conditions, all those engaged in credit granting;
- (c) collect and distribute information of an educational nature among its members;
- (d) hold periodical conferences where the members may meet, receive instructions, and exchange views and experiences regarding credit granting;
- (e) collect, correlate, and disseminate statistical data dealing with consumer credit, in order to assist its members and others engaged in consumer credit extension better to understand and apply the principles upon which such credit extension is based.

These aims are being actively supported through the medium of regular meetings held under the auspices of the local chapters. Speakers well qualified to deal with some specific phase of credit and collection procedure are engaged, or the meeting may take the form of an open forum through which frank discussion of mutual problems is made possible. Lecture courses covering subjects relative to consumer credit granting also form part of a well organized programme.

Women in the Field of Retail Credit

In addition to the part played by women both in the activities of credit bureau operation and in the Credit Granters' Association of Canada, an outstanding contribution has been made through the Credit Women's Breakfast Clubs of North America. This is a recognized affiliate of both the National Retail Credit Association in the United States and of the Associated Credit Bureaus of Canada.

Local units are operating in many credit bureau centres throughout Canada and, as the name would imply, their meetings are invariably held at the breakfast hour. The functions of these clubs might be termed supplementary to those of the Credit Granters' Association, and the chief objective is education to increase the efficiency of their members, and thus enhance their potential value to the firms they represent. Through the meetings, the value of cooperation is recognized, and an opportunity is provided for close association with others experiencing similar problems in the credit field.

The contribution of the Women's Clubs for charitable purposes and welfare work is substantial, monies for this purpose being raised through special projects.

The growth of these clubs and the support they have received from firms engaged in the extension of consumer credit are sufficient evidence of their importance and value.

Conclusions

The need for continued cooperation is becoming more and more apparent as the growth of retail credit is accelerated. Merchants who previously felt competent to conduct their own individual credit investigations have learned that, no matter how thoroughly they check the given references, they present only part of the necessary information. They must pool their respective credit experience for the benefit of one another. Cooperation is essential, if the maximum of sales volume is to be obtained with a minimum degree of risk.

Prompt and regular turnover of inventory will to a large extent be governed by the credit and collection policy adopted.

A sufficient customer equity should exist in all credit purchases and care should be taken at all times to guard against selling in excess of the customer's paying ability.

Public acceptance of the convenience and aid of credit has paved the way for considerable credit-sales expansion. In earlier years the credit customer was somewhat averse to publicizing his use of credit terms, but this feeling is now non-existent. The customer now rightfully places a high value on his ability to obtain credit privileges, which has been brought about through his own personal cooperation and care of previous obligations. A good credit record constitutes a most valuable asset.

What Western Oil Can Mean to Canadian Business

John R. White
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After analyzing the impacts of newly-discovered western oil on business in Alberta, Mr. White projects its increasing effects on business throughout Canada as the Dominion draws closer to oil self-sufficiency.

IT is of the greatest importance in appraising the impact of oil on Canadian business to know with what sort of eyes business is going to look at oil. It is easy to see that with the discovery of oil in the West, the oil industry will itself expand, but a more imaginative approach is necessary to see the secondary, tertiary and even more remote possibilities in the growth of oil.

No one can doubt that the possibilities which oil has opened up will be taken advantage of. Canada's democratic social organization is a guarantee that any opportunities that may be overlooked by one businessman will be quickly realized by his competitors. This application of multiple judgment assures that oil will not only find broader markets for itself but will bring greater and more varied activity in fields that are not even remotely connected with oil.

The Impact of Oil on Western Business

Canada's oil industry, born in Ontario, was reincarnated in the West only three years ago, but there is already a considerable volume of statistics to show that business horizons have widened. In western Canada and especially in Alberta, the addition of a potent new source of energy to a vigorous and ingenious people is having the sort of results one might expect.

The Immediate Effects of Oil Expansion

Last year, with Canadian consumption of petroleum rising 8% over the previous year, prairie consumption rose 17%. To accelerate twice as fast in a year as the rapidly rising national average is striking indeed.

Crude prices at most prairie points are today about one-third lower than they would have been if crude had to be railed in from the United States. A rough figure can be put on the saving in the cost of energy that is already being realized by prairie consumers. In 1949 petroleum prod-

ucts cost prairie consumers some \$30 millions less than would have been the case had prairie prices been based upon the cost of crude imported from the United States. By far the major part of this saving accrued to consumers in Alberta and Saskatchewan. Manitoba consumers may expect substantial benefits with the completion of the Interprovincial pipe line and the construction of additional refining capacity at Winnipeg.

Looked at from the point of view of the prairies as a whole, the development of Canadian crude to replace imported crude meant a \$30 millions dividend to the prairie consumer, roughly \$12 per capita or a cost per gallon of product some $3\frac{1}{2}$ cents lower than would have been the case if imported crude had been used. This calculation leaves out some imponderables, but it is simple, and on the whole conservative. Perhaps its greatest significance stems from the fact that western crude is still pressing outward, and that further price cuts to the consumer will appear in the future.

The Further-Reaching Effects of Oil Expansion

A good deal of the expansion currently taking place in the West is undoubtedly attributable to capital investment which may one day decline, but that same investment is building up a solid foundation for a permanently higher level of activity.

Last year, one hundred million dollars was spent on the search and development of oil, largely in Alberta. This year, with an anticipated \$150 millions in exploration expenditures, the effect should be still greater and will probably extend eastward into Saskatchewan. On top of this \$3 millions a week will come the other construction expenditures, scheduled for completion within the next 12 months, most of which will be in the prairies and which total more than \$125 millions.

But these direct oil expenditures are rapidly being supplemented by other activities. For example, press predictions in Edmonton place that city's 1950 building program at \$90 millions or more. Of this total, some \$18 millions represents direct expenditures by the oil industry. The balance includes a \$10 millions pulp mill, a \$5 millions addition to the MacDonald Hotel, \$5 millions' worth of schools, a continuation of the \$9 millions University of Alberta expansion, \$3.5 millions for new and enlarged churches, \$5 millions for retail additions, \$10 millions for office and commercial buildings, and \$25 millions for homes. As the *Edmonton Journal* points out, this long list of 1950 projects compares with a total of \$13 millions in city building permits issued in 1947, the year in which the Leduc discovery well came in. The figures show not only the size but the variety of the activity which has followed.

Another feature of the growth in Alberta has been the rise in population. The war and other factors had led to a temporary downtrend in

Alberta and Saskatchewan, a trend which reached its low in 1946. At that time, Alberta had a population of 803,000 and Saskatchewan had 833,000 people. In 1949, the downtrend had not only been reversed, but Alberta had for the first time become the most populous of the prairie provinces with a total of 871,000 people against 861,000 for Saskatchewan. In the three years following the discovery at Leduc, the province which had trailed by 30,000 had acquired a lead of 10,000 people. Needless to say, petroleum did not account for all these changes, but it can be safely assumed that it was an important factor.

One could add substantially to the list of new enterprises and new horizons that are appearing in the West, but the above remarks are perhaps enough to indicate that a general rather than a particularized expansion is taking place and that secondary and tertiary opportunities are in fact opening up.

How Expansion Has Affected Government Revenues

The discovery and development of petroleum in the West is adding substantially to provincial government revenues.

In Alberta, the province owns 93% of the subsurface mineral rights and receives most of the royalties from production. As a rule, one barrel in every eight taken from provincial acreage goes to the government. At the moment, these royalties are about \$20,000 per day, and with crude reserves of the province estimated at close to a billion barrels, the province is assured of an income of between \$200 and \$300 millions over the life of the presently known fields. In addition to royalties, the province also receives fees from reservations granted to oil seekers, and rentals of a dollar per acre per year from the granting of leases.

A much larger addition to provincial funds follows a crude discovery when the oil prospector selects the acreage he wishes to retain out of his original reservation. Subject to a special and rather complicated set of rules, the oil finder can keep no more than 50% of his reserved acreage, the balance reverting to the Alberta government for sale by tender. To date, some \$32 millions has been received by the government from these lease sales, for lands whose value was developed by the oil industry.

All told, petroleum today accounts for about 33% of the Alberta government revenues and the total is still mounting. The government's policy is that this portion of its revenues comes from the depletion of provincial assets and should be used for the creation of new capital assets which are taking the form of highways, hospitals, university facilities, conservation projects and similar works.

In one sense, these government revenues are perhaps only additions to the cost of oil. But they are also a sort of transfer payment, since part of the wealth developed by the oil industry builds up services which directly or indirectly benefit other forms of industry. Alberta's highway

program, for example, will certainly make some inroad on the difficulties of transportation which have been a traditional problem for industry in the West.

The Importance of Developments in Alberta

A good deal of space has been devoted to inspecting conditions in Alberta, but not solely because the future of that province is extremely optimistic. Alberta is undoubtedly one of the most promising provinces in the most promising country in the world. But it is also an exceptionally good laboratory in which to observe the kind of influence that the western oil industry will exert throughout the country.

The Impact of Oil on National Business Prospects

Returning to the national scene, the impact of oil on business prospects is twofold. In the first place, the capital expenditures being made in the search for oil and in providing facilities to market the oil already found account for roughly 10% of Canada's non-governmental capital investment program for 1950. Since the level of investment is commonly regarded as the most reliable barometer of prosperity, oil is presumably contributing to another year of prosperity and opportunity for all business in Canada.

In the second place, domestic petroleum is helping to improve Canada's balance of payments. In dollar terms, domestic oil saved the country \$90 millions American in 1949, is expected to save more than \$100 millions in 1950, and, with the completion of the pipe line to the Lakes in 1951, it is expected that Canadian oil will back out at least \$145 millions of American dollar oil.

This progress is clearly contributing to Canada's improved balance of payments position with respect to the United States and must be some factor in the recent removal of restrictions on imports by the Ottawa government—which of course will reopen many avenues of trade that had been temporarily closed to Canadian businessmen.

That there is still every reason to increase Canadian self-sufficiency in petroleum is indicated by the fact that we are still spending some \$300 millions annually on imported petroleum. Since the net national dollar deficit for 1949 worked out to about \$375 millions, there is some ground for the hope that oil self-sufficiency would tend to make possible the resumption of normal trade with the United States and other dollar areas.

This, however, is not a conclusion that can be made unreservedly. To date, Canada's national appetite for petroleum energy has grown with feeding, and it is quite possible that rising demand will absorb the growing output—and more besides. If this proves so, there will probably be cause for rejoicing rather than alarm, for the petroleum that costs us so many dollars is also one of our best "dollar-earners"—an invisible component of almost all our exports from forest products to the tourist trade.

Oil development should perhaps be viewed as a dollar-earner rather than a dollar-saver, with less emphasis on the dollar-oil that has been backed out and more emphasis on the increased productive energy that is being provided to all Canadians. For it is that extra energy, placed at the disposal of a people who have already achieved great things without it, which will help to realize so many other goals.

The Growth in Domestic Oil Consumption

In 1939 Canadians were consuming 169.4 gallons of petroleum annually per capita. Ten years later, they had boosted their consumption to 300.3 gallons, a rise of 77%. In comparison, the American consumption rose 57% during the same period and British consumption 34%. In that 10-year period, the quantity of gasoline supplied to Canadians has doubled, and the amount of heating oil has increased $3\frac{1}{2}$ times to the point where one out of every six homes is now heated by means of a power oil burner or an oil space heater. To sum it up in terms of energy, petroleum in 1949 was supplementing the muscular power of every Canadian with energy equivalent to that of 20 men.

All this growth took place without much direct stimulus from domestic sources of crude oil, except in the prairie provinces. At the beginning of 1949, Canadian oil output was not large enough to supply all the prairie refineries and it was only at mid-year that production caught up with and passed effective demand in these provinces. In short, less than 20% of Canada's people have as yet been supplied with western oil, and even today all the people in that area are not using domestic oil since the major gaps in refining capacity and transportation will not be filled in until 1951. In that year, the completion of the pipe line to the Great Lakes and the refinery at Winnipeg will push imported oil out of its last stand in the prairies and western oil will begin its penetration of the Ontario market.

What Oil Self-Sufficiency Will Mean to Canada

The kind of economy we would have in Canada if oil self-sufficiency is achieved is a difficult, yet economically most important, part of the picture. A few numbers can be mixed with a lot of imagination in an attempt to paint the kind of economy Canada may see when oil has been thoroughly absorbed into its system.

Any such effort will necessarily require a great many assumptions. It must be assumed that the western oil industry continues to develop up to and perhaps past the point of self-sufficiency for Canada. It is accordingly taken for granted that nature is still concealing several times as much oil as has yet been found; that men will be willing to continue looking for it and will succeed in their search; and that economic markets will be found for it. The scope of present programs will result in marketing less than a third of the oil required for Canadian self-sufficiency—

and the most easily marketed one-third at that. When it is remembered that these programs will cost more than 125 million dollars, including pipe lines, refineries and ships, it is immediately apparent how big an assumption we are making when we talk of self-sufficiency.

It nevertheless will certainly do no harm to take a look in the direction Canada is going, no matter how hazy the view. In a prewar comparison of consuming levels in the United States, Canada and Britain, there is at least a rough indication of the difference between a country which had its own domestic sources of petroleum and used it generously, and those which had to import oil and used it sparingly.

Before the war, when conditions in the three countries were perhaps more comparable than they are today, the Americans were consuming annually 329 gallons of petroleum per capita, the Canadians 169.4 gallons and the British just under 65 gallons. Even before the war there were certainly other major differences among the three economies. But the fact that the American worker's productivity was reinforced by nearly twice as much petroleum-derived energy as was the Canadian worker's, and more than five times as much as the British worker's, is in itself a big enough factor to explain many of the other differences.

In 1939 the oil-based economy was providing its people with a considerably higher living standard than was then available in the oil-deficient economies. Its people were getting about three times as big an annual dividend of new refrigerators as the people of either of the other countries, about twice as many new radios and new cars. They were spending one-and-a-half to twice as much on amusements and so on.

Figures on the altitude of American living standards are pretty familiar and there has been a wide variety of explanations for the truly admirable achievements of that country in the past 50 years. It is entirely possible that the development of the "Petroleum Age" during that same 50 years, and the fact that the United States was the scene and origin of the major petroleum developments, had a direct, causal bearing on American living standards.

Certainly, it is commonly recognized that Britain's pioneering in steam led to that nation's supremacy in the nineteenth century. It is also usually acknowledged that hydro-electric energy played a similar role in Canada, although to a more limited extent. Electricity helped to ease the problems caused by the location of coal in Canada, and so provided the only practical energy basis for such industries as newsprint and aluminum. It seems reasonable under these circumstances to look for the new form of energy which accounted for the rise of the United States, and to reach the conclusion that it was petroleum, in whose consumption that country has led the world.

As previously warned, this conclusion is statistically weak but economically important. In spite of its imperfections, anyone who is willing to go along with the conclusion will probably also agree that it is a conclusion of very great significance to the Canadian people.

For if the prospect of self-sufficiency in oil for Canada means that it is going to be easier to boost individual productivity up to or even past the American level, then there is every reason to look for comparable standards of living and levels of business activity. The Canadian can look for a general quickening of business, especially in those lines usually classed as luxuries, as mass markets mysteriously open up; he can look for greater mechanization, more emphasis on special service trades and specialty products.

These are the sort of developments that history promises when new sources of energy are placed at the disposal of a free and industrious people. They are the sort of things that followed the introduction of steam in Britain, hydro-electric energy in Canada, and petroleum in the United States. The probability that Canada will follow the same pattern is made all the greater by the rapid growth in per capita oil consumption, which, as already stated, has been occurring even without much prompting from domestic supplies of crude oil.

Conclusions

A good deal of ground has been covered in an attempt to get a business-eye view of oil developments in Canada. And while the data is still far from complete, it is possible to draw a few broad conclusions.

Oil is clearly opening new horizons for business in the West.

Oil is adding many millions to government revenues.

Oil is making an important contribution to capital expansion and so is stimulating general Canadian prosperity.

Oil is easing the exchange situation to some extent and is so furthering a return to normal trade.

Oil is providing extra energy for Canadians which, carried far enough, can be expected to bring a substantial advance in living standards with a corresponding widening of the avenues for business.

Finally, all the expansive force that has been released in the West will be multiplied if Canada can achieve self-sufficiency in crude. And this is still something for which business can hope—but of which business cannot as yet be sure.

Canada's "hope" of self-sufficiency in petroleum is not being left to hope alone. Right now, more than 240 oil-prospecting organizations, some large and many small, are engaged in producing the extra crude this country needs. More than 100 seismic crews are in the field probing the structures a mile or more below the surface. Behind them are some

50 exploratory drilling crews to find out if those structures hold oil. Contractors are at work on tanks to feed the giant pipe line. Other contractors are waiting to throw the line across 1,150 miles of bush and prairie. Preparations are under way for the pumping stations which will push the oil through the line. Two large tankers are taking shape at Collingwood and Port Arthur. At Winnipeg, the plans are in order for that city's first large refinery. At Edmonton, two other refineries are to be added in the near future. In scores of plants across Canada steel is being made and worked into pipe and the hundreds of other items needed in Canada's march toward oil maturity.

As business looks at oil in Canada today, it can see a great deal of hope and promise. It can also see that real progress is being made to turn these hopes into a reality.

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